

Chapter 3 Investment Policy and Industrial Policy in Indonesia

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3.1 Investment Promotion Policy

The intent behind the introduction of the new investment law, as indicated in the government's announcement, is summarized as follows.

The role and contribution of the investment sector is increasingly called for to accelerate the country's economic development, raise national income, increase government income in the form of tax revenue, increase the country's foreign currency reserves, and create jobs. Also, investment is expected to augment its role within the framework of the country's development policy while giving due consideration to macroeconomic stability as well as the economic balance between regions, between sectors, and between social groups, while supplementing the role of domestic projects and meeting requirements for good governance. The government's feasible efforts include the support for the improvement of business sustainability, and the improvement of competitiveness of local products through the promotion of partnership and cooperation between different economic units, including foreign and domestic investment.

Indonesia is increasingly facing intensive competition in attracting foreign investment and is thus required to establish an attractive investment climate for foreign companies. To achieve the goal, maintaining the stable macroeconomic conditions and assuring legal certainty and the streamlined investment process are prerequisites. The government is expected to provide an opportunity for foreign and domestic companies to operate freely, alone or in cooperation with others, in the favorable business environment. Furthermore, Indonesia needs to address the influence created by its participation in investment-related, bilateral and regional cooperation arrangements and treaties (the growth triangle (Indonesia, Malaysia and Thailand), East ASEAN growth region (Brunei, Indonesia, Malaysia, and the Philippines), and ASEAN (Association of Southeast Asian Nations) and WTO), by complying with agreements and other outcomes of the cooperative frameworks.

To aim at upward adjustment of the macroeconomic condition under the new investment law, the National Planning Agency (Bappenas) announced the Macroeconomic Plan for 2005 – 2009. The plan indicates the government's desirable role in driving the country to grow out of low levels of investment and export and sets forth various targets in order to fulfill the role. In particular, the average economic growth rate during the period is targeted at 5.7% and real income per capita is expected to grow by 20% over 2004. To meet these targets, the plan assumes that total investment increases by 140% in comparison to the period between 2000 and 2004, while domestic investment, domestic consumption, and export grow by 9.9%, 4.0% and 7.8% respectively.

The new investment law was discussed continuously at various ministries since 2003, based on the understanding that sluggish investment in Indonesia, both local and foreign origins, reflects the lack of confidence among investors in the country's investment climate. In June 2006, the bill was formally proposed to the Diet.

The bill is intended to amend the Law Concerning Foreign Capital Investment of 1967 (No.1) and its amendment of 1970 (No.11) as well as the Law Concerning Domestic Capital Investment of 1968 (No.6) and its amendment of 1970 (No.12), for the purpose of accelerating national economic development by increasing investment.

The proposed amendment of the investment law reflects the recognition that the role of the investment sector is critical in promoting the rise in national income, growth of tax revenue, the increase of foreign currency reserves, and creation of jobs. Before the amendment was taken up for discussion, the Indonesian government rested on the favorable investment climate endowed with a large potential market and natural resources and failed to develop the institutional infrastructure that is required to develop its high investment potential into a truly attractive investment climate. Since the Asian currency crisis in 1997, sluggishness of foreign investment and the slow rate of economic recovery compared to other Asian countries have caused the government to have serious concern and decide on the proposed amendment.

3.1.1 Key Factor for Improvement of Indonesia's Investment Policy

The key factor for improvement of the country's investment climate is the fact that "it has failed to develop the institutional infrastructure to attract investment by having too much confidence in its potential market and rich natural resources," as criticized by various parties. In fact, the draft new investment law uses "integrated service" as a key word for the amendment. According to the "Doing Business 2007" report published by International Financial Corporation (IFC) that belongs to the World Bank Group, Indonesia is placed 135th in the Investor-friendly Ranking (out of 175 countries surveyed), with no improvement compared to the previous year's results (131st out of 151 countries surveyed). In contrast, China, which is a major rival as host country for foreign investment, advanced from 108th to 93rd during the same period. Thus, despite the government's concern, Indonesia's investment climate as perceived by the international community is still lagged behind its rivals and the difference seems to be rather widening.

Table 3-1 Investor Friendly Ranking

Country	Investor-friendly rank
Singapore	1
Hong Kong	5
Japan	11
Thailand	18
Malaysia	25
China	93
Vietnam	104
Philippines	126
India	134
Indonesia	135
Cambodia	143

Source: World Bank, IFC (Doing Business 2007) Total country compared: 175

Source : IFC, Investor Friendly Report 2007

The same ranking on countries in East Asia and the Pacific region is shown below.

Table 3-2 Investor Friendly Ranking in East Asia and Pacific Area Countries (1/2)

Economy	Ease of Doing Business Rank	Starting a Business	Dealing with Licenses	Employing Workers	Registering Property	Getting Credit
		1	2	3	4	5
Cambodia	21	21	22	21	16	23
China	16	20	21	16	5	11
Fiji	5	8	6	10	13	4
Hong Kong	2	1	13	7	8	1
Indonesia	20	23	18	22	18	8
Kiribati	12	13	14	8	10	11
Lao PDR	22	14	17	15	19	22
Malaysia	4	12	19	11	12	2
Marshall Island	15	3	2	1	21	16
Micronesia	18	6	4	6	21	11
Mongolia	7	8	8	14	3	7
Palau	13	7	11	4	2	16
PNG	10	11	15	9	11	11
Phillipines	19	19	16	20	15	11
Samoa	6	16	12	5	8	8
Singapore	1	2	3	2	1	3
Solomon Is.	14	15	10	13	20	20
Taiwan	8	17	20	23	6	6
Thailand	3	5	1	12	4	5
Timor-reste	23	22	23	19	21	21
Tonga	9	4	9	3	17	16
Vanuatu	11	10	7	17	14	16
Vietnam	17	18	5	18	7	8

Source: IFC, Investor Friendly Report 2007

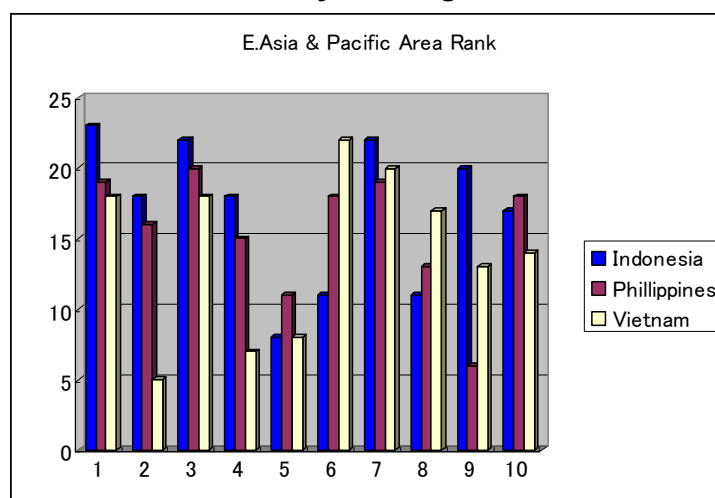
Table 3-2 Investor Friendly Ranking in East Asia and Pacific Area Countries (2/2)

Economy	Ease of Doing Business Rank	Starting a Business	Dealing with Licenses	Employing Workers	Registering Property	Getting Credit
		1	2	3	4	5
Cambodia	21	11	4	20	16	20
China	16	15	23	6	8	8
Fiji	5	4	10	15	10	12
Hong Kong	2	2	1	1	1	3
Indonesia	20	11	22	11	20	17
Kiribati	12	7	3	4	18	20
Lao PDR	22	22	7	22	21	20
Malaysia	4	3	10	9	9	6
Marshall Island	15	18	14	18	15	15
Micronesia	18	20	9	7	19	19
Mongolia	7	4	12	23	3	13
Palau	13	20	15	14	22	7
PNG	10	7	18	10	11	10
Phillipines	19	18	19	13	6	18
Samoa	6	4	8	12	5	16
Singapore	1	1	2	2	2	1
Solomon Is.	14	10	6	5	14	11
Taiwan	8	11	16	8	7	2
Thailand	3	7	13	19	4	4
Timor-reste	23	17	21	16	23	20
Tonga	9	16	17	3	17	9
Vanuatu	11	11	5	21	11	5
Vietnam	17	22	20	17	13	14

Source: IFC, Investor Friendly Report 2007

Notably, one should draw attention to Indonesia, Vietnam, and the Philippines. The next graph compares the three countries, as extracted from the above ranking. Note that the items on the horizontal axis are same as those in the previous tables.

Figure 3-1 Investor Friendly Ranking in East Asia & Pacific Area



Source: Prepared by the study team on the basis of data presented in Investor Friendly Report 2007, IFC.

While the mainstream of foreign investment in Asia continues to be headed for China, Vietnam is in a favorable position to win the place after China. Despite the high reputation, Vietnam does not seem to have a clear advantage over Indonesia in terms of investment climate. It does not have rich natural resources or a large domestic market. Its infrastructure is no better than that in Indonesia. Although it may have some advantage in terms of industrial amalgamation and physical logistics as its primary industrial base, Hanoi, is in close proximity to the southern China and the two areas are connected by highway, the country has problems relating to corruption and the lack of transparency in investment procedures. In fact, the UNCTAD's data indicate that the investor friendly ranking does not necessarily show a high level of accordance with the actual amount of foreign direct investment (see the table on the next page).

Table 3-3 Table FDI to China and ASEAN

Unit: Million US\$

	2000	2001	2002	2003
China	40,715	46,878	52,743	53,505
Hong Kong	61,939	23,775	9,682	13,561
ASEAN 6	21,699	17,936	12,973	17,416
Indonesia	-4,550	-2,977	145	-597
Malaysia	3,788	554	3,203	2,474
Philippine	1,345	982	1,792	319
Singapore	17,217	15,038	5,730	11,409
Thailand	3,350	3,814	1,068	1,802
ASEAN 4	1,680	1,666	1,562	1,685
Vietnam	1,289	1,300	1,200	1,450

Source: World Investment Report 2004, UNCTAD

Note: Because of the increasing competition with China, the number of large investment projects in the ASEAN region is on the decline. In particular, Indonesia is facing a net decrease in foreign direct investment as its economic and political conditions have been substantially affected by the Asian currency crisis.

The fact that investment in Vietnam grows faster than its place in the investor friendly ranking suggests that factors other than the indices used in the ranking affect actual investment decisions.

The graph in Figure3-1 indicates that Indonesia ranked lowest in six out of ten items in the "economic environment" category. Box 3-1 summarizes comments on Indonesia made about the items. Among them, "Item 9 Enforcing Contracts" is noteworthy that a large number of procedures and considerable time and cost are considered to be main reasons for poor evaluation.

BOX 3-1

1. Starting Business (2006)

The challenges of launching a business in Indonesia are shown below. Entrepreneurs can expect to go through 12 steps to launch a business over 97 days on average, at a cost equal to 86.7% of gross national income (GNI) per capita. They must deposit at least 83.4% of GNI per capita in a bank to obtain a business registration number.

2. Dealing with Licenses (2006)

The steps, time and costs of complying with licensing and permit requirements for ongoing operations in Indonesia are shown number of procedures, days and cost(capital per income). It takes 19 steps and 224 days to complete the process, and costs 311.00% of income per capita.

3. Registering Property

The ease with which businesses can secure rights to property is measured below. In Indonesia it takes 7 steps and 42 days to register property. The cost to register property there is 10.5% of overall property value.

4. Employing Workers

The difficulties that employers in Indonesia face in hiring and firing workers such as difficulty of hiring, rigidity of hours index, difficulty of firing, rigidity of employment, hiring cost and firing costs are applied to evaluate the rank. Each index assigns values between 0 and 100, with higher values representing more rigid regulations. The Rigidity of Employment Index is an average of the three indices. For Indonesia the overall index is 44.

5. Registering Property

The ease with which businesses can secure rights to property is measured by procedure, time and cost. In Indonesia it takes 7 steps and 42 days to register property. The cost to register property there is 10.5% of overall property value.

6. Getting Credit

Measures on credit information sharing and the legal rights of borrowers and lenders in Indonesia are evaluated by legal rights, credit information, public registry coverage and private bureau coverage. The Legal Rights Index ranges from 0-10, with higher scores indicating that those laws are better designed to expand access to credit. The Credit Information Index measures the scope, access and quality of credit information available through public registries or private bureaus. It ranges from 0-6, with higher values indicating that more credit information is available from a public registry or private bureau.

BOX 3-1

7. Paying Taxes

The effective tax that a medium size company in Indonesia must pay or withhold within a year is evaluated by number of payments, time and total tax rate. Entrepreneurs there must make 52 payments, spend 576 hours, and pay 37.21% of gross profit in taxes.

8. Trading Across Borders

The costs and procedures involved in importing and exporting a standardized shipment of goods in Indonesia are number of documents for export, cost to export, number of documents for import and cost of import. Every official procedure involved is recorded - starting from the final contractual agreement between the two parties, and ending with the delivery of the goods.

9. Enforcing Contracts

The ease or difficulty of enforcing commercial contracts in Indonesia is measured by number of procedures, time and cost of debt. It takes 34 steps and 570 days to enforce contracts there. The cost of enforcing contracts is 126.54% of debt.

10. Closing Business

The time and cost required to resolve bankruptcies are evaluated. In Indonesia, the process takes 5.50 years and costs 18.00% of the estate value. The recovery rate, expressed in terms of how many cents on the dollar claimants recover from the insolvent firm, is 11.76.

3.1.2 Outline of the New Investment Law

Prior to the drafting of the new investment law, BAPPENAS announced the “Package for Improvement of the Investment Climate in March 2006 in order to show its basic policy that constitutes the new investment law. The package summarizes action plans and responsible ministries and agencies in a matrix form (including a timeframe), covering key elements of the investment climate (general government policy, currency, customs/tariff, taxation, labor force, and SMEs, etc.) according to the organization of the new investment law.

The bill for the new investment law was laid before the Diet in June 2006 and has still to be enacted as of October. The above package indicates the basic concept of the new investment law. (See Annex “Summary of Investment Policy Package.”)

(1) Policy package for the improvement of the investment climate

In the area of general policy, the following three projects are proposed.

- ◆ Strengthening of investment service organizations

- ◆ Harmonization of central and local government regulations
- ◆ Improvement of transparency in regulations relating to environmental impact assessment

In the area of customs/tariff, the following four projects are proposed.

- ◆ Streamlining of physical distribution
- ◆ Functional enhancement of bonded areas
- ◆ Eradication of smuggling activities
- ◆ Simplification of tariff-related procedures

In the area of taxation, the following five projects are proposed.

- ◆ Tax incentives for investment
- ◆ Establishment of a self-declaration system
- ◆ Revision of VAT for export
- ◆ Protection of taxpayer's rights
- ◆ Promotion of transparency and disclosure

In the area of labor force, the following six projects are proposed.

- ◆ Protection of Indonesian overseas workers and mediation service for recruitment and employment
- ◆ Quick, low-cost and fair solution of labor disputes
- ◆ Creation of a flexible and productive labor market
- ◆ Promotion of transmigration-related development projects within the employment expansion framework
- ◆ Strengthening of SME unions

3.2 Foreign Support for Improvement of the Climate Investment

3.2.1 Framework for Support through CGI

After the completion of the IMF program at the end of 2003, various donor countries and international organizations continue to provide support through the Consultative Group Meeting on Indonesia (CGI). The Indonesian government seeks to establish equal relations with donor countries and chaired the CGI meeting in 2005. About the framework to decide on support programs through the CGI, it has been pointed out that it is overly diversified in terms of covered areas as a result of participation by a large number of donor countries and organizations. In response, working groups were created in 2003 and the CGI meeting in 2004 held informal sector-based sessions, although the attempt did not work well. The government seems to have the intention to reform the CGI and reorganize it to a forum focusing on national development policy through discussion with major donors. And it expects Japan, the largest donor country, to promote CGI reforms.

3.3 Indonesia/Japan Strategic Investment Action Plan

In the area of Indonesia-Japan relations, the “Indonesia/Japan Public and Private Sectors Joint Investment Forum” was established in December 2004 for the purpose of promoting Japanese investment. In May 2005, the forum formulated the Indonesia/Japan Strategic Investment Action Plan (SIAP).

The SIAP proposes 118 action plans for the improvement of the investment climate and requests the Indonesian government for responding to them affirmatively. The action plans essentially contain improvement proposals to address day-to-day operational problems facing private companies that are key members of the JJC, and thus they are essential in healthy management of investment projects.

3.3.1 Historical Background of the SIAP

The historical background of the SIP is described in this section. As the follow-up of the SIAP is led by the JJC, its report seems to be suitable for the understanding of the SIP and its activities, so that a general outline and progress status of the SIAP, as presented below, are borrowed from the JJC report.

The SIAP was announced in Tokyo, on June 2, 2005, as an Indonesia/Japan joint initiative to promote foreign investment. It was based on an agreement made at a top-level meeting between President Susilo Bambang Yudhoyono (SBY) and Prime Minister Koizumi on November 20, 2004. On December 16 of the same year, the Indonesia/Japan High-level Public and Private Sectors Joint Forum was held in Jakarta to launch its formal preparation process.

Since the announcement of the SIAP by the two governments in June 2005, the Indonesian Chamber of Commerce and Industry (KADIN) and the JJC have been working jointly to accelerate the implementation of the SIAP that consists of 118 activities and programs. They are now operating four working groups in the following areas: taxation/custom, labor force, infrastructure, and industry’s competition/SMEs.

On December 22, 2005, the third joint forum was held under the joint chairs of Indonesian Minister of Trade, H.E. Marie Elka Pangestu and the Ambassador of Japan to Indonesia (Mr. Iimura) and heard progress reports directly from the four working groups for mid-term view.

To support activities of the joint investment forum, an advisory team was created, consisting of seven experts (four Indonesian and three Japanese). It held the first meeting on December 22, 2005 to discuss on a variety of issues, including the investment climate, macro economy,

infrastructure, and public service.

3.3.2 Progress of the SIAP

In December 2005, the SIAP's Planning & Coordination Board conducted evaluation of the country's investment climate and proposed recommendations for its improvement. The board members recommended that the evaluation results submitted and the above recommendations be reported to the top levels of both governments. Then the four working groups have been carrying out the exchange of information and opinions on SIAP-based activities and programs since the announcement of the SIAP in June 2005.

The board revealed that up to December 2005, 40 out of 118 action plans contained in the SIAP had been already implemented or revised entirely.

The board admired the Indonesian government's efforts to reduce unemployment, which produced favorable results and clear signs of improvement. It also prompted the working groups to make further efforts to realize improvement, according to the expected timeframe, on the issues that did not show a significant progress.

The board emphasized that the monitoring of the action plans would be important to assure their realization. Furthermore, the board designated ten priority action plans among those in the SIAP in terms of important (see Box 3-2) and prompted the government to ensure that improvement activities can be swiftly and timely implemented, by underlining its importance to win the fierce competition within the ASEAN region to attract foreign investment to the country.

BOX 3-2

Ten priority Action Plans

The Planning and Coordination Committee, while acknowledging the importance of all the items listed in the SIAP, stresses that the following "10 Priority Actions" of the SIAP are extremely important for improving investment climate in Indonesia in the short term and deserve higher attention from the leadership and the relevant authorities of the Indonesian government. It is hoped that those Priority Actions would be reflected in concrete actions/measures or policies of the Indonesian government in the near future.

(A) Tax /Custom

(1) Review of withholding tax and tax collection system, including fiscal tax, by establishing a dialogue with tax policy makers from MOF etc.

- *Reducing withholding tax
- *Reforming tax prepayment systems
- *Reviewing fiscal tax as prepayment of income tax

(2) **Review of proposed VAT law to ensure 0% VAT on Export/ Offshore services**

(3) **Review of the regulation on bonded warehouse** to meet business needs.

(4) **Improvement of work ethics and transparency of customs administration**

*Utilizing hotline/help desk services to monitor the work ethics of customs officers

*Socializing the regulation and its interpretation of regulations

(B) Labor

(5) **Review of the Labor Law and regulations** to ensure the competitiveness of private companies

*Easing the regulations on dismissing the worker for grave misconducts

*Revising the regulations on severance payment

*Easing the regulations on outsourcing

(6) **Simplification of the procedure to obtain business visa** for smooth business activities of expatriates

*Revising relevant regulations/ guidelines and socializing to the Police

C) Infrastructure

(7) **Establishment of a PPP framework, including risk management mechanism for power and other infrastructure projects**

*Establishing PPP network and developing PPP guideline

*Starting development of Institutional framework for Risk Management and Study on Procedure and Mechanism on obtaining various kinds of government support

(D) Industrial Competitiveness/SME

(9) **Implementation of the industrial policy, including promotion of supporting industries**

*Making and implementing industrial policy based on the strategy of three industrial sectors

*Specifically supporting the mold and die industry association to be established for creating sufficient number of skillful labor for mold and die industry

(10) **Early enactment of the Investment Law for consolidated investment policy**

*Submitting the draft Investment Law to the Parliament as soon as possible

*Implementing consolidated investment policy by monitoring private sector's preferences on tax incentives, facility of BKPM and the role of National Team for Investment and Export Promotion (PEPI)

Source: JJC(Jakarta Japan Club)

3. Update of the Working Groups

a) Tax /Customs

i) Tax

Members of the Tax Working group appreciated that the Directorate General of Tax (DGT) initiated a series of sub-group meetings with the business community to exchange views and

opinions on the issues related to the SIAP before the submission of a package of amendments to the Tax Laws to the Parliament in September 2005. Despite those efforts, members of the Working group, especially the business community, thought that major important issues suggested in the SIAP were not fully reflected in the new amendments.

Therefore, in their view, not much progress has been made on tax in the SIAP, except for certain areas where concrete progress was observed thanks to the effort of DGT. For example, major progress was made in the field of raising public awareness on tax payment by introducing a guideline to fulfill tax return application through website, and some progress was observed in systematizing tax knowledge base etc.

Among the tax issues listed in the SIAP, withholding tax system and monthly tax collection system, including fiscal tax, is pointed out as one of the constraints for investing in Indonesia, especially for supporting industries, in comparison with neighboring countries. Given the existing perception gaps among the members of the Working group on key issues such as review of proposed VAT Law to ensure 0% VAT on export/offshore services, promoting fair treatment of taxpayers and other issues, further in-depth discussion would be required in the forthcoming Working group meetings. It is also suggested that a dialogue with policy makers on tax system from Ministry of Finance etc. might be an useful approach for widening the scope of discussion.

ii) Customs

On customs issues, thanks to the efficient and effective initiative of the Directorate General of Customs and Excise (DGCE), progress has been made in many areas, such as removing administrative obstacles for speedy customs clearance. Although continuous monitoring would be needed, DGCE has taken positive steps to improve governance and enhance discipline of customs officials by issuing circular letters to the heads of Customs Offices, by setting up Hotline (or online reporting) on DGCE side etc.. “Joint Seminar on EDI system” in October and modified DGCE website were also welcomed by the business community.

While improvement in work ethics and transparency of customs administration should be pursued further, and review of the regulation on bonded warehouse would be required, major challenge ahead on customs issues would be effective enforcement and implementation of those actions/measures that have been already taken or introduced.

b) Labor

Since many outstanding issues of the Working group are related to the forthcoming review of the Labor Law and regulations, the progress has been slower than expected. However, thanks to a series of intensive dialogue on outstanding issues in the Working group meetings, together with “Workshop on Dismissal/Severance Payments”, organized by JICA and Ministry of Manpower and Transmigration (MoMT) in November, it is noted that mutual understanding among the participants has been deepening on key issues such as easing the regulations on dismissing the worker for grave misconducts, revising the regulations on severance payment and easing the regulations on outsourcing. It is hoped that ongoing productive dialogue in the Working group would be well reflected in the review process of the Labor Law and regulations.

Simplification of procedure to obtain business visas for foreign expatriates remains to be one of the top priority issues for the JJC.

c) Infrastructure

Although 37 out of 42 actions were expected to be done, only 14 actions have been completed by December. While there are several remarkable progresses, such as issuance of new Presidential Decrees on ministerial forum (KKPPI) and the government-private cooperation on infrastructure development, revision of the road tariff policy and establishment of a new independent toll road regulatory body (BPTJ) and amendments of some infrastructure related laws proposed to the Parliament, the Working group does not see current general progress is satisfactory. It is noted that there are several actions with insufficient recognition by relevant authorities, which hinder active discussions and that the momentum of GOI as a whole should be enhanced to achieve the remaining actions. The Working group put the stress on two series of actions, establishment of a PPP framework including risk management mechanism to promote investment in power and other infrastructure projects by facilitating participation of private investors, and immediate actions to ease the traffic jam in Jakarta Metropolitan Area to promote investment in manufacturing industries by providing them with competitive transportation infrastructure.

d) Industrial Competitiveness/SME

It is noted that the target of the Working group is to make the government play more active role in investment promotion or industry policy than focus on regulatory reform. With close cooperation with Ministry of Industry and other relevant ministries, more than half of actions have been completed, which include strategy reports of three industry sectors and a series of supporting industry promotion programs (reverse parts exhibition, investment mission and promotion seminars). There are also some movements in the private sectors like the one to establish a mold and die industry association as a center for human resource development in this field. It is noted that the Working group welcome the current progress in this part and will work on the further actions for industry policy, including promotion of supporting industries. Another issue the Working group has strong interest is early enactment of the new investment law, as the new investment law is recognized as fundamental legal framework for the government to implement consolidated investment policy such as tax incentives, facility of BKPM and the role of National Team for Investment and Export Promotion(PEPI).

Note :Outline of SIAP is as shown below (Action plans by category are listed in ANNEX)

Strategic Action Plan (SIAP)

I Tax and Custom clearance

- 1) Introduction and expansion of self-enumeration system in tax payment (*)
 - 2) Improvement of VAT for export promotion
 - 3) Protection of tax payer's rights
 - 4) Promotion of transparency and information disclosure in tax levying
 - 5) Reexamination of taxation system to reduce business cost
 - 6) Reexamination of taxation system to promote people-to-people exchange
 - 7) Continuation of dialogue between business and public in taxation issues
 - 8) Quick elimination of political barrier for smooth custom clearance operation (*)
 - 9) Improvement of professional ethics in custom clearance operation
 - 10) Publicity of common understanding to new custom regulations (*)
 - 11) Introduction of EDI system and official Website of custom office (*)
 - 12) Expansion of function for bonded warehouse
 - 13) Promotion of transparency and fairness in custom clearance operation
 - 14) Improvement of other constraints in custom clearance operation
- (*): JICA will cooperate with some project

II Manpower

- 1) Reevaluation of manpower relating regulations and acts to accelerate market competitiveness (*)
 - 2) Implementation of proper measures to settle labor dispute rapidly and fairly (*)
 - 3) Establishment of social system such as vocational training, labor exchange and national licensing system that ensures transparent, flexible and productive labor market (*)
 - 4) Simplification of visa procedure to ensure smooth business activity of aliens
 - 5) Establishment of practical social security system
- (*): JICA will cooperate with some project

III Infrastructure

- 1) Strengthening of political renovation and enactment of regulations to promote private investment
 - 2) Enact practical national plans for infrastructure development
 - 3) Close discussions among investors, stakeholders and the government to realize infrastructure development
 - 4) Improvement of infrastructure conditions which encourage FDI (*)
- (*): JICA and JBIC will cooperate with some project.

IV Industrial competitiveness and Small and Medium Industry development

- 1) Preparation of industrial development strategy to reinforce industrial competitiveness
- 2) Promotion of supporting industry
- 3) Strengthening of public services of BKPM to investors
- 4) Protection of property rights in local market
- 5) Introduction of international industrial standards

3.3.3 Improvement of Investment Climate and Position of BKPM

Despite the fact that the SIAP targeting to improve “doing business” aspect, the mission and a contents of activities of BKPM mainly targeting “starting business” aspect. Moreover, Japan-Indonesia Public and Private Joint Forum is mainly targeting to improve business performance environment in the Republic from the investor’s point of view.

Promotion activity by introducing comparative advantage to encourage potential investors and to improve investment climate that obstructs actual business activities are closely related each other and is considered as two wheels of vehicle. In addition, development of promotion tool would be a significant activity of BKPM to accelerate foreign direct investment into the Republic.

That is to say, such activities as 1) elimination of business barriers (to give a political guarantee to business sector to maintain their commercial operation in healthier condition), 2) development of cost competitive business environment within the country (in labor wages, import/export operation, entering domestic market), 3) development of more attractive investment promotion tools, 4) expressing government’s clear attitude to welcome FDI and 5) aggressive promotion would be a criteria to accelerate foreign direct investment into the Republic.

3.4 Outline of the Strategic Action Plan (RENSTRA) of Ministry of Industry

3.4.1 Background of the Plan

The mid-term development strategy developed by BAPPENAS points out that the manufacturing sector, which is expected to serve as a major driving force for economic growth, loses competitiveness due to the unfavorable business environment. By referring to the competitiveness ranking in the 2004 World Economic Forum (WEF), which ranked Indonesia at 69th out of 104 countries, whereas its major competitors in the ASEAN region- Thailand and Malaysia – ranked 34th and 31st, respectively, BAPPENAS’s strategy perceives the decline in competitiveness as a serious concern.

Then, the strategy lists the following factors for deterioration of the county’s competitiveness.

- (1) Unhealthy macroeconomic conditions
- (2) The inability of government organizations to serve as the “service center” for industry
- (3) Ineffective technology development policy to promote the improvement of competitiveness
- (4) Inefficient business operation at the corporate management level
- (5) Lack of the supporting environment to maintain sound competitiveness

Then, the following issues are raised on the basis of the result of analysis by IMD

(International Institute for Management Development)

- (1) Poor performance of the national economy in terms of international trade, investment, labor and price stability
- (2) Lack of policy coordination due to inefficient operation of government organizations and duplication of power and authority relating to fiscal management and policy, or legal control for the favorable business environment, as well as complex social structure
- (3) Poor productivity, a less than optimal labor market, poor access to financial resources, and the lack of the effective business ability to promote responsible production and innovation as reflected in poor management capability in terms of professionalism
- (4) Limitation of the basic infrastructure required for physical and technological infrastructures as well as people's education and welfare

In addition to the issues relating to the macroeconomic environment, microeconomic issues – those relating to the shop floor – are discussed using an index developed by UNIDO to compare competitiveness of industry, called Competitiveness Industrial Performance (CIP)¹. The discussion is summarized as follows (also see Figure 3-2).

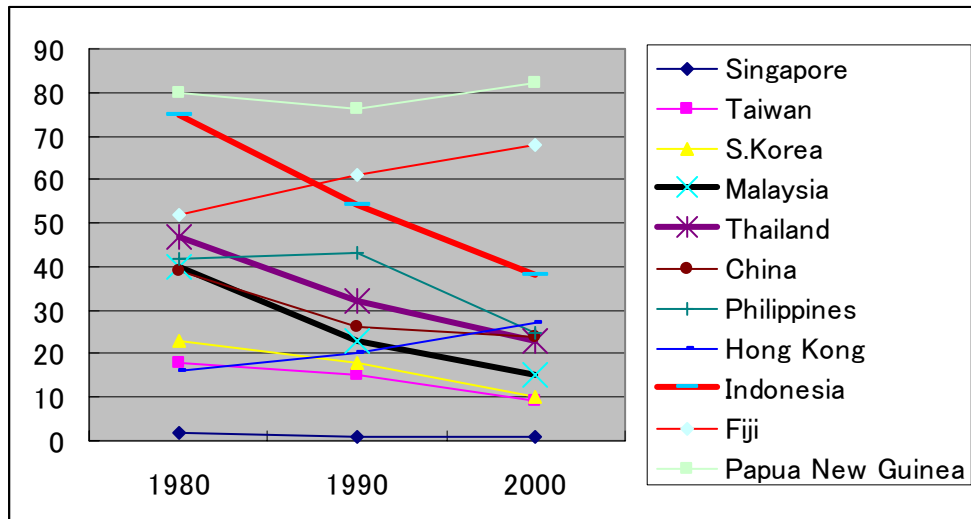
Specifically, manufacturing enterprises in Indonesia face the following issues: (i) development and implementation of production technology is very limited; (ii) presence of impediments to improvement of science and technology in the production field is supported by the country's low industrial-performance by technology level, ranked 60th among 72 countries; and (iii) there are problems relating to the labor environment, infrastructure development, and human resource development.

The above issues at macro- and micro-economic levels have adverse effects on those at business and industry levels. As a result, organizational and human resource development efforts to upgrade skill levels at individual enterprises have not produced results as expected. For instance, labor productivity has not been improved. Based on the indicator comparing the rise in real wage and the increase in value added per worker in the manufacturing sector, productivity shows a declining trend throughout manufacturing industries. Similarly, development of national standards for industrial products, the efficient development of infrastructure according to industrial demand, and the improvement of labor skills do not progress very well due to limitation of input resources.

¹ CIP consists of four key indices: (a) per-capita value added by the manufacturing sector; (b) per-capita export by the manufacturing sector; (c) the level of industrialization measured by the level of contribution by the manufacturing sector as percentage of GDP and the level of contribution of by manufacturing enterprises having intermediate and advanced levels of technology to the entire manufacturing sector; (d) the level of contribution by the manufacturing sector as percentage of total exports and the level of contribution of by manufacturing enterprises having intermediate and advanced levels of technology as percentage of exports by the manufacturing sector.

The following graph compares competitiveness trends of manufacturing industries in selected countries in East Asia, including ASEAN countries competing with Indonesia.

Figure 3-2 Performance of Manufacturing Industries in East Asia (1980 - 2000) (93 countries)



Source : UNIDO. Industry Development Report 2004

From the mid-term development program, therefore, it is clear that industrial development will continue to be treated as major issues.

3.4.2 Constraints Discussed in the RENSTRA

Major issues addressed: High unemployment rate, poverty, low economic growth, poor export capability, insufficient infrastructure, and low level of technology

3.4.3 Two Pillars of the Development Strategy

【Basic strategy】

- (a) Reinforcement of industrial networks, including supporting industries, related industries, and infrastructure/utilities industries
- (b) Reinforcement of industrial productivity, efficiency and diversity, and use of recyclable resources
- (c) Input of development promotion/competitiveness strengthening measures: Business protection, technology/management support, promotion of synergy between large enterprises and SMEs, and SME support

【Implementation strategy】

(a) Industrial promotion through cluster development and strengthening, and identification of priority industry groups

- ***Priority industries in the transportation equipment sector: Automobiles and shipbuilding***
- Priority industries in the ICT sector: Computer hardware and software, and communications equipment
- ***Priority industries in the parts supplier and capital goods industries: Electrical machinery and equipment, and agricultural machinery and equipment***

(b) Priority development of the business environment

(c) Development of the business environment

- ***Promotion of human resource development for industry in the technology and business management fields***
- ***Promotion of industrial testing, research and development services***
- ***Promotion of industrial consulting service***
- ***Reinforcement of infrastructure development in the region with high potential for industrial development***

(d) Promotion of innovation and management capabilities through industrial R&D and technology development initiatives

(4) Target goals for industrial development

Long-term development goals as well as mid-term ones are established under the RENSTRA and are summarized below.

Mid-term (2005 – 2009) goals	Expected performance
<ol style="list-style-type: none"> 1. Development of industries that can create a large number of jobs 2. Effective execution of industrial revitalization, consolidation and reconstruction programs 3. Optimization of local markets for development of local parts supplier industries and industries processing natural resources 4. Continuous improvement of competitiveness of export-oriented industries 5. Growth of industries that can drive future industrial development 6. Growth and development of SME industries, in particular, acceleration of medium-sized industries (three times the pace of development of small-sized industries) 	<ol style="list-style-type: none"> 1. Amelioration of the unemployment problem in the industrial field 2. Recovery of industries hit hard by the economic crisis 3. Rise in local content, especially raw materials and parts 4. Significant growth of export 5. Building of future industrial pillars 6. Reinforcement of the industrial structure
<p style="text-align: center;">Long-term (2010 – 2020) goals</p> <ol style="list-style-type: none"> 1. The strengthened manufacturing base to develop world-class industries 2. Emergence of strong industries as a major driving force for economic growth 3. Substantial contribution of smaller enterprises to GDP, compared to large industries 	<p style="text-align: center;">Expected performance</p> <ol style="list-style-type: none"> 1. Establishment of a newly industrialized country status on the basis of input of innovative industrial concept on a substantial basis

Development concept for sectors (manufacturing industries) that have strong association with the proposed SME human resource development plan

1) Development concept for subsectors that are positioned as the implementation strategy area and are entitled to priority development

(a) Strengthening of basic competitiveness

a. Basic recognition

Industry groups that form the backbone of the manufacturing industry have potential and opportunity to made significant contribution to the increase in value added by the manufacturing sector, and at the same time, they need to be supported from the viewpoint of furthering national welfare. There is recognition on that, to promote development of these groups, it is critical to eliminate impediments for them to acquire their own capabilities in the technology and R&D fields.

b. Direction of manufacturing base strengthening

To strengthen the manufacturing base, support is provided in the following areas:

- Restructuring and strengthening of competitiveness
 - Increase in investment
 - Strengthening and multi-layering of the industrial structure
 - Increase in production capacity
- c. Priority sectors for strengthening competitiveness of the manufacturing base
- Sectors relating to local demand: Household appliances, textile and garment, footwear, ceramics and porcelain
 - Sectors relating to parts supply and capital goods: Electrical machinery and equipment, machine tools, factory equipment, agricultural machinery
- d. The framework for industrial promotion targeting priority sectors associated with the proposed project

A general framework of promotion targeting priority sectors associated with the proposed project (household appliances, electrical machinery and equipment, textile and garment, footwear, machine tools, factory equipment, automobile industries)

【Household appliance industry】

Core industry: Household appliance	Supporting industries: Glass, chemical, cable, plastics, paint, parts, rubber	Related industries: Office supply, household goods, entertainment
<p style="text-align: center;">Mid-term (2005 – 2009) goals</p> <ol style="list-style-type: none"> 1. Total investment of US\$2.5 billion, including development of supporting industries 2. Increase in export value from \$2.3 billion to \$5.5 billion 3. Creation of 150,000 jobs 		<p style="text-align: center;">Long-term (2010 – 2020) goals</p> <ol style="list-style-type: none"> 1. Local supporting industries become the backbone of the household appliance industry. 2. Investment of \$4.5 billion, export of \$9.5 billion, and creation of 300,000 jobs 3. Development of world as well as local brands
<p>Strategy</p> <p>Sector: Promotion of supporting/parts industries; improvement of investment in the household appliance industry; and protection of the domestic market</p> <p>Technology: Improvement of technology integration capability through assistance of multinationals; and improvement of the local R&D bases</p>		
<p style="text-align: center;">Mid-term action plan (2005 – 2009)</p> <ol style="list-style-type: none"> 1. Building of local household appliance, parts, and supporting industries through collaboration with principal/multinationals 2. Introduction of SNI (standard) and technical regulation for protection of industry and 		<p style="text-align: center;">Long-term action plan (2010 – 2020)</p> <ol style="list-style-type: none"> 1. The local parts industry becomes a major sector to support self-sufficient operation of the local household appliance industry. 2. Emergency of the local household appliance industry capable of supplying

domestic market 3. Promotion of the establishment of the electrical industry center 4. Building of the household appliance industry in Indonesia as a major world production base 5. Give Incentives to industries to promote technology transfer, research and development, and local brand production	locally designed products to the export market
Support elements	
<u>Technology upgrading steps</u> a. Introduction period (2005 – 2009): Licensing b. Rapid development period (2011 – 2015): Technological upgrading and integration c. Maturing period (2016 – 2020): Industrial upgrading <u>Market</u> a. Building of international market network b. Brand development	<u>Human resources</u> a. Human resource training and improvement of design capability for ISO 9000 <u>Infrastructure</u> a. Promotion of investment in industrial estates b. Tax incentive for investment in industrial estates

【Electrical machinery and equipment industry】

Core industry: Electrical machinery and equipment	Supporting industries: Machinery industry, engineering support, steel plates, pipes, boilers, pressure vessels, heat exchangers, molding	Related industries: Electrical machinery and equipment parts, cable industry, factories, thermal/combined cycle power generation, power transmission and distribution networks, EPC service, power plants
Mid-term (2005 – 2009) goals 1. Increase in local content relating to power generation 2. Increase in electrical machinery and equipment exports		Long-term (2010 – 2020) goals 1. Establishment of technical capability to build power plants by using local design and engineering resources 2. Increase in use of local electrical machinery and equipment for construction of 30MW or smaller power plants
Strategy Sector: Improvement of quality of electrical machinery and equipment Technology: Improvement of machine design and engineering capabilities		
Mid-term action plan (2005 – 2009) 1. Increase in use of local electrical machinery and equipment for construction of 50MW or smaller power plants 2. Formulation of technical standards for 30MW or smaller power generation, electrical machinery		Long-term action plan (2010 – 2020) Strict enforcement of technical standards

and parts 3. Building of parts supply and supporting industries for electrical machinery and equipment	
Support elements	
<u>Technology upgrading steps</u> a. Introduction period (2005 – 2008): Licensing b. Rapid development period (2011 – 2015): Upgrading and integration of production technologies c. Maturing period (2016 – 2020): Industry upgrading <u>Market</u> a. Development of electrical machinery and equipment export markets (ASEAN, Middle East, Africa)	<u>Hunan resources</u> a. Upgrading of skills in the production technology field <u>Infrastructure</u> a. Incentive for use of locally manufactured electrical machinery and equipment for local power generation and distribution projects

【Textile and garment industry】

Core industry: Textile and garment industry	Supporting industries: Chemical industry; Machinery and equipment; synthetic fiber; natural fiber; textile/chemical industry	Related industries: Rubber products; garment; furniture; toys; footwear; geotextiles; accessories; suppliers
<p style="text-align: center;">Mid-term (2005 – 2009) goals</p> 1. Maturing of the industrial structure due to increase in investment (total investment expected in 2009: 187,750 billion rupees) 2. Export value expected in 2009: 11.8 billion rupees 3. Protection of the domestic market (value of production: 126,640 billion rupees; per capita consumption – 36.3m) 4. Increase in job creation capacity (1.6 million persons in 2009) 5. Increase in use of locally produced textile and garment products for export purposes 6. Increase in exports to non-traditional markets 7. Development of Indonesian brands for export		<p style="text-align: center;">Long-term (2010 – 2020) goals</p> Improvement of competitiveness by supplying high fashion textile and garment products using high value added, locally produced materials
<p>Strategy</p> Sector: Increase in value added through the value chain and the improvement of competitiveness through the understanding of the international market trend Technology: Promotion of growth of the highly responsive, high quality textile industry		
<p style="text-align: center;">Mid-term action plan (2005 – 2009)</p> <ul style="list-style-type: none"> • Implementation of the reconstruction program for textile 		<p style="text-align: center;">Long-term action plan (2010 – 2020)</p> <ul style="list-style-type: none"> • Promotion of the synthetic

<p>and garment production machinery and equipment</p> <ul style="list-style-type: none"> • Promotion of the reconstruction process through the provision of IT and financial source • Upgrading of quality of locally available raw materials: Development of alternative materials and sources (such as silk and cotton); intensification of R&D on raw materials; improvement of synthetic textile materials; and improvement of materials relating to textile and garment products • Competent professionals/skilled workers; personnel engaged in industrial restructuring; professionals in design, marketing and technology; and reconstruction of textile machinery • Establishment of design/fashion centers 	<p>fiber/textile industry, such as high performance textile and geotextiles</p> <ul style="list-style-type: none"> • Product diversification and design/technology development for high value added and high fashion products
Support elements	
<p><u>Technology upgrading steps</u></p> <p>a. Rapid development period (2005 – 2015): Design development; high fashion product development; natural fiber-related technology; certification and standardization; development of high speed/high quality textile machinery</p> <p>b. Maturity period (2016 – 2020): Industry upgrading</p> <p><u>Market</u></p> <p>a. Upgrading of international market networks and brand development capability</p> <p>b. Protection of domestic markets</p> <p>c. Improvement of access to non-traditional market</p>	<p><u>Human resources</u></p> <p>a. Human resource development in design/fashion field</p> <p><u>Infrastructure</u></p> <p>a. Design school/training institute: Establishment of Fashion Institute</p> <p>b. Special credit for renewal/upgrading of textile machinery</p>

【Footwear industry】

Core industry Footwear	Supporting industries: Leather industry, synthetic leather, rubber, adherent, machinery and equipment, chemical, accessories, and textile	Related industries: Sport goods, fashion products
<p style="text-align: center;">Mid-term (2005 – 2009) goals</p> <ol style="list-style-type: none"> 1. Export growth at an annual average rate of 7%, reaching \$1.8 billion 2. Share expansion of local brand shoes in the local and export markets 3. Production increase (value basis) at an annual average rate of 10% 4. Employment growth at an annual average rate of 4%, 100,000 jobs in total 		<p style="text-align: center;">Long-term (2010 – 2020) goals</p> <p>Becoming a major producer and exporter of shoes in the world market.</p>
<p>Strategy</p> <p>Sector: Promotion of the footwear industry that produces local brand shoes using locally available materials; retention and augmentation of investment in international brand sport shoes</p>		

Technology: Promotion of growth of the molding industry and upgrading of design capability	
<p>Mid-term action plan (2005 – 2009)</p> <ol style="list-style-type: none"> 1. Promotion of the local brand shoe industry 2. Improvement of product quality by adopting technical standards, and upgrading of skills in the design and production technology fields 3. Promotion of investment in supporting industries for collaboration between the footwear industry and local vendors 4. Implementation of R&D on leather materials, alternative materials, and supplemental materials, perfection of the production process, and design improvement 5. Development of the business environment through exemption of value added tax/customs duty for indirect exports, and imposing of export tax on wet blue leather and crust finished products 6. Upgrading of high quality leather processing capability as well as industry's ability to supply high quality products 7. Promotion of shoe production training centers 	<p>Long-term action plan (2010 – 2020)</p> <ol style="list-style-type: none"> 1. Continued strengthening of the footwear industry structure through development of material supply and supporting (accessory production) industries 2. Promotion of the footwear industry capable of supplying world quality shoes
Support elements	
<p><u>Technology upgrading steps</u></p> <ol style="list-style-type: none"> a. Introduction period (2005 – 2009): Upgrading of production capability to produce high quality products suitable for export markets b. Rapid development period (2010 – 2015): Use of locally processed leather materials of export quality <p><u>Market</u></p> <ol style="list-style-type: none"> a. Building of global sales networks b. Promotion of collaboration with global makers 	<p><u>Hunan resources</u></p> <ol style="list-style-type: none"> a. Upgrading of skills in the design and molding fields b. Promotion of efforts to develop the footwear industry that can supply world quality shoes <p><u>Infrastructure</u></p> <ol style="list-style-type: none"> a. Construction of design and product training centers and promotion of renewal/upgrading of shoe making machine b. Increase in the role of R&D on new shoe materials

【Production equipment/machine tool industry】

Core industry: Boilers, pressure vessels, heat exchangers, machine tools	Supporting industries: Steel plates, design, pipes and tubes, welding rods, production equipment and parts	Related industries: Production facilities and equipment, thermal power generation, combined cycle power generation ; EPC
<p>Mid-term (2005 – 2009) goal</p> <ol style="list-style-type: none"> 1. Rise in capacity utilization rate of production equipment industry, at least 75% 2. Promotion of R&D on local production technology 3. Shift of local EPC contractor's role from 		<p>Long-term (2010 – 2020) goals</p> <ol style="list-style-type: none"> 1. The industry becomes capable of manufacturing a variety of production equipment and machine tools according to a wide range of

subcontractor to principal contractor 4. Augmentation of machine tool related investment	specifications. 2. Improvement of export capacity
Strategy	
Sector: To make oil & gas, energy, mining and infrastructure development as the basis of promoting the local production equipment industry. Technology: Improvement of design and engineering capabilities relating to production equipment and licensing from foreign companies	
<p style="text-align: center;">Mid-term action plan (2005 – 2009)</p> 1. Cooperation with foreign companies for promotion of industries manufacturing production equipment and parts, and machine tools 2. Upgrading of R&D centers relating to production equipment design and engineering 3. Development and introduction of SNI for production equipment for the purpose of protecting the local market 4. Indication of industrial investment locations in the entire country	<p style="text-align: center;">Long-term action plan (2010 – 2020)</p> 1. The industry becomes capable of manufacturing a wide range of production equipment required by the manufacturing sector. 2. Use of collaboration initiatives with foreign companies for increase in market access
Support elements	
<p style="text-align: center;">Technology upgrading steps</p> a. Introduction period (2005 – 2008): Licensing from foreign companies b. Rapid development period (2011 – 2015): Modification and integration of production technologies c. Maturity period (2016 – 2020): Industry upgrading	<p style="text-align: center;"><u>Hunan resources</u></p> a. Upgrading of skills in the manufacturing field
<p style="text-align: center;"><u>Market</u></p> a. Strengthening of promotion to Asia and Africa within the framework of non-block, South/South cooperation	<p style="text-align: center;"><u>Infrastructure</u></p> a. Promotion of incentive for factories and supporting industries that conduct R&D activities

【Automobile industry】

Core industry: Motorcycle and motor vehicle industries	Supporting industries: Engines and parts, transmissions and parts, suspensions, car bodies and parts, universal components, iron and steel, glass, plastics parts, accessories, rubber, and carburetors	Related industries: • Maintenance and repair service • Sales and dealer service • Transportation service
<p style="text-align: center;">Mid-term (2005 – 2009) goals</p> 1. Production of motor vehicles, totaling 4,750,000 units per year to meet 90% of local demand, with annual export growth of 10% 2. Annual motorcycle production of 5 million units, with annual		<p style="text-align: center;">Long-term (2010 – 2020) goals</p> 1. The industry has automotive product design and engineering capabilities.

<p>export growth of 10%</p> <p>3. Production capacity to meet 80% of parts demand for assembly of motor vehicles, implementation of in-house engineering of motorcycle parts, with parts export growth of 10% per year</p>	<p>2. The industry can contribute to world class design and engineering activities.</p>
<p style="text-align: center;">Strategy</p> <p>Sector: Promotion of production bases for commercial vehicles, small vehicles, and motorcycles, and advancement of production technology for the parts industry</p> <p>Technology: Full manufacturing development, design and engineering capabilities for motorcycles</p>	
<p style="text-align: center;">Mid-term action plan (2005 – 2009)</p> <ul style="list-style-type: none"> • Improvement of investment in the 2nd and 3rd tier supplier industries • Upgrading of the parts industry’s capability through the systematic learning of production technology and techniques • Improvement of productivity and quality of the parts supplier and assembly industries • Improvement of SME industry’s capability and linkage with assembly industries • Phased introduction of the gas fuel discharge system (EURO2) • Eradication of pirate/illegally copied automotive parts in the aftermarket 	<p style="text-align: center;">Long-term action plan (2010 – 2020)</p> <ul style="list-style-type: none"> • Construction of Automobile R&D Center • Improvement of collaboration among the automobile, raw materials supply industries, and advanced education and training institutes • Improvement of collaboration with major auto industries in the world • Utilization of global sales networks for automotive parts
<p style="text-align: center;">Support elements</p>	
<p><u>Technology upgrading steps</u></p> <ol style="list-style-type: none"> 1. Motorcycles <ol style="list-style-type: none"> a. Rapid development period (2005 – 2009): Full manufacturing, motorcycle design and engineering b. Maturity period: Local brand development and industry upgrading 2. Motor vehicles <ol style="list-style-type: none"> a. Investment (2005 – 2010): Parts design and engineering in the country b. Maturity period (2011 – 2020): Design and engineering of assembled cars (commercial vehicles and small vehicles), full manufacturing <p><u>Market</u></p> <ol style="list-style-type: none"> a. Increase in export to ASEAN countries b. Improvement of collaboration with parts suppliers <ul style="list-style-type: none"> * Reinforcement of global sales networks * Development of parts trade centers 	<p><u>Hunan resources</u></p> <ol style="list-style-type: none"> a. <u>Upgrading of skills for advancement of production technology and skills</u> b. <u>Upgrading of skills in the management and engineering fields</u> <p><u>Infrastructure</u></p> <ol style="list-style-type: none"> a. Construction of an automobile export/import port b. Harmonization of tariff c. Provision of tax allowance for new investment and expansion d. Tax credit and incentive for promotion of human resource development and R&D e. Construction of Automobile R&D Center f. Upgrading of testing organization’s capability for skill certification g. Provision of incentive for priority areas

Chapter 4 Investment Climate Comparative Study

Chapter 4 Investment Climate Comparative Study

4.1 Background and Objective of the Survey

4.1.1 Background

The Republic of Indonesia has experienced a lower level of growth rate at around 4% since the Asian financial crisis in 1997 and 1998. The growth has been somehow supported by domestic consumption, which is not enough to absorb increasing labor force pumped into labor market every year. These results in huge number of unemployment and underemployment population, which is estimated more than 40 million.

Amid the economic and social difficulties, the Yudoyono Administration faces challenging the task of alleviating poverty as well as improving the investment climate. The improvement of the investment climate is expected eventually to accelerating poverty alleviation. A primary driving force of poverty alleviation is to create employment opportunities. In order to enlarge employment opportunities, in the meantime, further economic growth is indispensable. Indeed, it is said that achieving a 7.5% annual growth rate is required to curve the current unemployment rate. Then, the driving force to realize the high economic growth is the investment. So the improvement of investment climate is regarded as urgent matter.

The New Five Year National Development Plan 2004-2009 provides concrete action plans for improving the investment climate such as:

- a) completing legislation in the filed of investment;
- b) simplifying the procedure for investment service;
- c) providing attractive investment incentives;
- d) integrating the investment planning system of central and local government;
- e) monitoring, evaluating, and managing domestic and foreign investment;
- f) developing information system of investment in the both central and provinces;
- g) strengthening investment related organizations in the both central and provinces; and
- h) studying investment policies of Indonesia and other countries

The investment climate of Indonesia has been improved at fast pace so far. Indeed, some of investment related systems have already been amended. The Parliament currently discusses the new investment bill. Following several modifications from a viewpoint of efficacy and viability, the bill is expected to be approved and to be enforced by the end of this year. The joint economic forum between Japan and Indonesia submitted proposals for improving Indonesia's investment climate, based on which the Strategic Investment Action Plan (SIAP) was

formulated. Hence, the coming investment law is anticipated to have consistency with the concept of the SIAP. Indeed, many of related ministries to whom the Study Team made interviews, envisaged the law to follow the concept of the SIAP.

The essential features of the new law are that, firstly, the law may provide the most deregulated framework among Asian countries so as to establish comparative advantage in the region. Second, turning from the past negative view that investment preferential treatments that it is against economic principle since the financial crisis, the law may regard them as necessary tools for attracting investment and apply it to wider subjects. Third, the law may take further step toward simplification of the investment procedures including deregulation with introducing necessary systems.

4.1.2 Objective of the Field Study

The improvement of the investment climate contains is not easy task because it covers very wide range of topics which deeply interrelate with each other. Hence, no government institute can realize the planned investment climate policies alone unless it makes coordination among concerned ministries. For instance, when the Ministry of Commerce or the Ministry of Industry plans to introduce fiscal incentives in order to promote investment into industrial parks or economic preferential zones, they showed to obtain approval from the Ministry of Finance. Because, fiscal incentive have significant impacts on the Government tax revenue. Similar cases are observable in implementing infrastructure development projects with PPP. The line ministries such as the Ministry of Energy, the Mineral Resources, and the Ministry of Public Works and so on give priority to public welfare in conducting infrastructure projects, while private investors tend to put emphasis on fiscal viability of the projects. In order to promote private investment to those projects, each ministry have to coordinate with the Ministry of Finance about a risk sharing framework with the private investors including a government support scheme and a guarantee fund.

A failure to achieve the initial goal of a system is often caused by a defect in the administrative operation of the system rather than a contradiction or a defect in the system. A report compiled by the World Bank indicates that it takes much longer days for investors to establish company in Indonesia than in rival countries. The report shows that the number is 33days in Thailand, while 151 days in Indonesia. This big delay may be attributed to a problem in an administrative operation rather a defect in the system. This explanation, however, is still no more reliable than a hypothesis because of limited number of related surveys. The current investment licensing system has been significantly simplified, including the procedure of receiving investment applications at BKPM, the production of required documents at notary public office, and company registration at the Ministry of Law. Thus, any operational delays are less likely to happen in those procedures. Instead, it may occur at side administrative operations

of the investment procedure. For example, some of notary publics are so idle that they spend time to create unnecessary documents or procedures. Moreover, a bank sometimes obstructs the procedure with delay in issuing an evidence for paid up capital.

The purpose of the comparative study between Indonesia and the neighboring countries is to learn the superior administrative operations of those countries. Our concern is not to identify each country's strong points in the investment climate. Instead, we try to put emphasis on the country's experience for each topic who has successfully cope with the difficulties similar to that Indonesian is facing. The study is expected to learn those countries' experiences and knowledge which would give Indonesia tips to improve its investment climate. The Study Team focuses especially on the following four topics in order to understand their efforts to expand investment.

(1) General outlines

The 1st field survey of comparative study was conducted at both Viet Nam and Thailand during February to March, 2006. The first study focused mainly in the starting-business and doing-business aspects in target country. The result of analysis of the study will fully be utilized at policy recommendation. However, improvement of investment climate is so difficult because the climate extends across various socio-economic areas and co-relates each other. Therefore, obtained data is necessary to filter from the political and socio-economic point of view. In addition, there are more political aspect to be considered as discussed in the Chapter 3. That is "investment promotion" activity as introduced as "Stage 1".

Investment promotion is one of the important focal point to be learnt through the comparative study. And, one more focal topic, infrastructure development, is on going concern in the Republic. BAPPENAS, Coordinating Ministry and Ministry of Trade concern the promotion policy in Indonesia. And, infrastructure development and maintenance is superintended by Ministry of Energy and Natural Resources while water business is concern of the Municipal government, introduction of fiscal incentives is Ministry of Finance, register of company is Ministry of Justice and Human Rights. In order to use the current investment climate of Indonesia as an indicator to evaluate the result of comparative study, practical procedure and operation has been identified at these public entities of Indonesia.

Leading agent of investment promotion in Indonesia is BKPM though roll and rights become ambiguous after decentralization. According to a draft new investment law, BKPM may be ousted from investment approval but function as investment registration front desk though objective and details are not clear now. Therefore, it is not able to compare with BOI Thailand in view of the same condition.

- (2) Variation of promotion method because of socio-political background.

Big difference between Thailand and Indonesia in terms of investment climates is: integrated investment service based on centralized governmental power in Thailand. As for the centralization of governmental power, enforcement of investment strategy and its implementation is centralized by the government of Viet Nam. Decentralization in Indonesia is a main stream which can not be stopped. Centralization and decentralization causes the big difference in laying down investment strategy so that it is necessary to evaluate the political background at first.

- (3) How to utilize the result of the 1st field study into the Study in China

In China, an essential investment policy is made by the government and the relating action plans and strategies are relied on the decision of municipal government. This is a typical decentralization system. However, intensive investment promotion service is easily executed by administrative order within the frame of autocratic political system.

- 1) To learn practical and effective operation of strategic industrial estates: Industrial estates, special economic zones, special industry intensive estates

As for industrial promotion and investment promotion policy in China, the principal object is put to use the budget efficiently. Their industrial strategy is characterized by intensive development to special promotion area. In fact, Chinese government considers that they can offer the foreign investment an attractive investment climate as a result of promoting industrial concentration and due accumulation of administrative services.

Industrial concentration, strategic industrial estate and intensive budget allocation for accelerated improvement will be the key word for investment comparative survey in China.

- 2) Foreign capital preferential policy

After the economic reconstruction in China, intensive infrastructure development at SEZs, special development area and coastal cities has been carried out in due understanding that it will be a good strategy for investment promotion. However, pace of infrastructure development is not catch up with the boosting of economic scale. Especially, development of power supply and distribution network becomes constraint of investment climate. Development strategy is important focal point of the comparative study.

- 3) Public services for export promotion

Export promotion policy and public services to promote exportation could be a significant factor as it is understood that foreign capital promotion equals as export promotion.

The reason why majority of investment is is export seekers. Therefore, contents and quality of public services rendered to export business in industrial estates and special economic zones become important non-fiscal incentives to FDI.

(4) Field Study in the Philippines and focal point to learn

1) Long history in FDI promotion but not identify the effects

In 1950s, the Philippines were the top runner of industrialization in South-eastern Asia. However, political turmoil as well as political instability prevents the Philippines from the economic development. That is, FDI is not boosting in the country not because of the political failure but political instability. It is apparent from the questionnaire made by JETRO.

2) Comparatively well developed public service to investors but complicated

On the other hand, there are many semiconductor based precision electronic appliances manufacturers such as Texas Instrument, Intel, Motorola and FUJITSU in the Philippines. Accordingly, industrial estates are well developed than neighboring countries. As customs clearance and other exporting and investing procedures are provided at one shop center within the parks. These public services will be a good sample to Indonesia. On the contrarily, it is difficult for a new investors to chose BOI, PEZA(preferential economic zone association), CEZA(CAVITE economic zone association), CDC(Clerk economic zone development corporation) or SBMA.

3) Infrastructure

Private participation condition, especially for NAIA3 and power plant will be a practical lesson for Indonesia.

4) Important subject to be studied

The comparative study in the Philippines focuses into the following topics.

- a) Administrative method of SEZs, Export processing zones and other industrial zones
- b) Content of services of one stop action service center and hearing from investors on practical evaluation
- c) Governmental policy to PPP

(5) Field study at China and topic prioritization at the study

1) Intensive industrial estates

Currently, south China area was caught on development of automotive production integrated industrial estate as well as strategic development zones. Progress of auto-

manufacturing based industrial concentration in Shenzhen, Dong guang and Guangzhou is rapid now.

Strategy to develop integrated industrial estate and its history such as promotion method, contents of incentives, function of estates and quality of governmental services are the main topics for the study team to be learnt.

2) Merits and difficulties to operate in SEZs

Development of SEZs is believed as one of the main factor of rapid economic growth in China. However, each region as Beijing, Shanghai and Shenzhen has different progress of growth and development. Therefore, it is necessary to start argue a point by understanding each background and history of growth.

For example, there is neither national priority university nor national level research institute in Shenzhen. The SEZ in Shenzhen developed its own technological basement by promoting research and development activities in private sector. After the appointment as SEZ in 1980, Shenzhen has been nurtured a regional R & D center and pushed ahead industry-university joint development within and out of city.

4.2 Result of the Comparative Study

4.2.1 Thailand

(1) Comparative analysis on investment climate between Thailand and Indonesia

1) Negative List

In Indonesia, the negative list is defined by the presidential decree, while, in Thailand, it is provided in the Foreign Business Act.

2) Definition of foreigner

In Indonesia as well as In Thailand, foreigner is defined as natural person without Indonesian nationality and corporate body without a legal entity in Indonesia. If even a small amount of foreign capital participates into a corporate body, it is defined as a foreign invested company (PMA) and, thus, subject to a different regulation from the domestic industries.

3) Labor code

a) Retirement allowance

A retirement allowance in Indonesia is composed of a severance allowance and a severance pay. The following table shows the comparison of applicable allowances corresponding to each working period in Indonesia and Thailand, although the two definitions of working periods are different.

Table 4-1 Retirement Allowance

Working period	Allowance period	
	Indonesia	Thailand
Less than 1 year	1 month base salary	0 to 30 days base salary
3 years	6 months base salary	180 days base salary
10 years	13 months base salary	360 days base salary
20 years	17 months base salary	360days base salary

It should be noted for Indonesia that:

- There additional obligations such as a purchase of salaried pay, a payment for coverage of a medical insurance.
- In cases of a voluntary redundancy, a punitive dismissal, or a layoff, the payment should be two times as much as that in the table.

The difference between Indonesia and Thailand in the short term seems to be negligible. In Indonesia, however, longer the period is, higher the payment is. In Thailand, there is a cap for the amount of retirement allowance, and this may be the salvation of the investors. The system of Indonesia is better for labor protection, while it incurs much cost for investors than that of Thailand.

In order to foster skilled labors, Indonesia should introduce a cap for the amounts of retirement allowance.

b) Labor dispute

Comparing the law between Thailand and Indonesia, the former provides more concrete regulation. The law related labor dispute in Indonesia stipulates abstractly that it is legal to go on strike to protect the life of workers with seven days prior notice.

c) Minimum wage

In Indonesia, the Labor Minister announces a minimum wage of each local government and province in each year, although local and provincial governments, in practice, derive the figures. In our opinion, however, the Thailand system should be better

than Indonesia's one, in which system the central government decides a basic guideline including a rate of base up and the local government makes their own decisions following the guideline.

d) Foreigner employment permits

- It is same as Indonesia that a foreign worker in Thailand must obtain a work permit and a long stay permit separately. In Thailand, however, those who have the license issued by the BOI or IEAT can obtain those documents at the one stop service center of either institute.
- In Indonesia, investors must pay DPKK (Skill and Development Fund) in advance in obtaining long stay permission, while Thailand does not have such a rule. This rule in Indonesia has a bad reputation from the investors.

e) Short term work permit

The rules and systems of Thailand's foreign employment are much better developed than that of Indonesia. In Thailand, all the urgent but short term works can be covered by the rules. In Indonesia, obtaining a short term work permit takes too much time to deal with an urgent task. In fact, even in those cases, many foreigners enter into Indonesia without having a work permit with negotiating the immigrant officers illegally. Although those illegal entries have not created a serious problem, they have worsened the image of the investors to Indonesia. Posed a negative image

f) Customs

- Time required to clear through customs

Table 4-2 Custom Clearance Time

	Green Line	Red Line
Indonesia	3 hours	3 days
Thailand	15 to 40 minutes	3 hours

As the above table shows, there is a big difference between the two countries. The factor to let Indonesia take more time than Thailand may be that the port services related parties has such strong sectionalism that they can not contemplate making a joint effort to shorten the time. During our study in Indonesia, we found some opinions to acknowledge the Customs Office's efforts. The above figures, however, may trigger complaints to the Government's effort again.

3) Taxation

- a) In Indonesia, an importer should pay 2.5% (7.5% without import license) of the total amount of a CIF price and import duties for each imported goods in advance. This imposes a big burden on importers and makes the reputation of the taxation system of Indonesia worse.
- b) A resident in Indonesia have to pay a tax for embarkation which is treated as a partial advance payment of individual income tax. This implies that if an employer bears the cost of the embarkation tax imposed to his employee, the payment is treated as an advance payment of the employer's income tax. Thailand does not have such a rule.
- c) Thailand has a regulation on advance payment of corporate tax, which requires a company to pay in each six months. In Indonesia, however, a company has to disburse an advance tax payment every month. Many Japanese firms have a claim on the time span for this tax payment. It should be at least each three months.
- d) Even the Government of Thailand tends to delay refunding a VAT. Unlike Indonesia, however, they do not delay about one year.
- e) The computerized tax payment system has been widely spread in Thailand, while it has been partially penetrated in Indonesia. The basic policy of collecting tax in Thailand is self-assessment. A taxpayer obtains the amount of tax by filling required figures in an application form. Then, he pays the amount through:
 - internet bank;
 - e-payment;
 - cellular phone;
 - telephone;
 - bank counter;
 - post office; or
 - convenience store if tax payer is individual.

A taxpayer is not necessary to submit any extra documents unless he receives a request from a tax office.

4) Incentive schemes

- a) In Thailand, there is a clear link between the government industrial policy and the incentive schemes of investment. This link can be seen in the organization structure of the BOI, which has two section; one is the implementation section composed of the Incentive Management Department, the Industry Department, and the Non Industry Department; and the other is the policy formulation section composed of the Prime Minister as Chairman, the Industrial Minister as Vice Chairman, and economic related ministers, economic bureaucrats, Industrial Association of Thailand, and representatives of major business institutes.

- b) The incentive schemes are more than industrial policy because it aims to disperse industry to regions so as to alleviate income gap.
- c) In Indonesia, it is unobvious who among the Finance Ministry, Industrial Ministry, and BKPM takes the leadership of the incentive schemes. We believe that Indonesia would be in the time of establishing close links among related ministries.
- d) Thailand poses a clear vision of industries to which foreign investment should be encouraged, preparing specific incentives to them. On the other hand, in Indonesia, the industrial policy mentions the priority sectors in terms of investment, although it fails to show concrete action plans to promote investment.

5) Investment promotion

- a) Their activities are almost same, while the quality of services is significantly different. The BOI, which stands on a viewpoint of the investors, provides much better services than BKPM. Indonesia is likely to be able to learn much on the quality of services provided through the Website from Indonesia.
- b) In Indonesia, neither BKPM nor the Ministry of Industry, who disseminate information on the Website, provides mediation services.
- c) Indonesia should consider introducing a troubleshooting service to investors in conjunction with the other ministries.
- d) The Website services of BKPM provide information only on the category of business and the contact addresses of the local manufactures and companies. The Website does not provide any useful information to find out appropriate partners, because it lacks information such as product lines, accredited standards, the share of engineers to total employees, and main clients.
- e) The Investment Club Association is the more advanced system than the investment counseling services of BKPM. It is apparent that the BOI tries to cope with the needs of investors beyond ministerial frameworks. The association is an informal organization, and thus the services are not free of charge. It, however, still has a big advantage to provide services exactly sought by investors.

6) Investment procedure

- a) In Thailand, the normal time for completion of the normal procedure, in which an investor establishes a company after obtaining the BOI license, from applying to the BOI license to beginning operation is four to five months. Considering this figure and the fact that a similar procedure takes 150 days in Indonesia, we may be able to say that Indonesia's figure is not considerably longer than Thailand's.
- b) The cause of the one month difference as seen in a) may be that concerned ministries in Thailand has the common vision to stimulate investment in conjunction with the BOI. Each ministry seems to issue unconditionally a license under its authority to an

- application without examinations, if the BOI permission accompanies with it.
- c) Even an investor who applies to the One Stop Service has to obtain the license and permission of the BOI before coming to the service. Such system may enable the BOI to monitor indirectly the investment application procedures of each project.
 - d) Furthermore, the BOI has established the Investment Facilitation Division so as to solve problems faced by investors in conjunction with other ministries. Applying this system to Indonesia may be worth considering.
 - e) The Government of Thailand has carried out one day campaign of customs to train the customs officials, while the Government of Indonesia does not have such a strong leadership.
 - f) The Customs Department of Indonesia covers only 20% of whole customs related administration, and thus the problem of customs clearance time seems to be beyond their efforts. Besides of the Customs Department, other factors such as improving port facilities should be considered to mitigate this problem. In the meantime, the customs officials may be able to mitigate the external obstacles by taking more positive actions. For example, the problem that it takes a time for customs officers to receive a container at an inspection station can be improved by their positive action to go to the place where the container is placed.
 - g) Indonesia has spread the use of EDI partially and not in bonded area. In Thailand, on the other hand, EDI has been widely used throughout the country, and thus the Government can handle requests from importers whenever the Government receives.
 - h) Because of the computerized customs clearance system, an importer rarely faces a customs official. This results in leavening few opportunities for them to give or demand a bribe.
 - i) The principle of customs clearance in Thailand is to believe declaration of an importer. Because of this principle, the Customs Department inflicts a severe punishment on an importer if they find that the importer has committed a custom violation. This reaction to a custom violation in Thailand seems to be more strictly executed than in Indonesia. The difference of the reaction may be one of factors of creating the gap in the time required to clear customs between the two countries.

4.2.2 Vietnam

(1) Comparative analysis on investment climate between Vietnam and Indonesia

1) Labor

Although Vietnam emphasizes to guarantee the right of labor as a socialist country, it seems to sift investor-oriented policy to revitalize economic development. Vietnam would be a strong competitor to Indonesia due to the policy change of Vietnam.

Labor system in Vietnam does not have big difference with Indonesia. However, there are some more realistic treatments in Vietnam. For example, visa and work permit are not required if the foreigners visit Vietnam within 15 days.

Also, no wage payment system during the legal strike under the new Labor Code in Vietnam is same as what investors request in Indonesia and it would be expected that Vietnam will introduce investor oriented system in Labor Code.

2) Taxation and customs

The bribes of custom office still exist even though they are decreasing. The situation is almost same with Indonesia. The seminars that intended to improve moral would not be effective measures and it might need the building of the new system that does not require face to face contacts between customs officers and tax payers.

Vietnam has predominant by providing investment incentives for the invertors. The government clearly shows intention to welcome investment by providing investment incentives for encouraged industries, enterprises that create certain number of employment.

3) Promotion activities

The promotion activities in Vietnam do not have comparative advantage in terms of contents and quality of services.

Vietnam has already delegated the authority to issue investment licenses to local governments based on types of industries, the investment amount, etc. Also, under the certain conditions, investors can obtain the investment license only with the registration. On the other hand, as one of the evaluation steps, asking the opinions and comments to related Ministries seem to be not a transparent process.

4.2.3 China

(1) Investment law

Basic policy for foreign direct investment as well as company establishment and other necessary laws are entrusted by the central government. In December 1798 the 3rd plenum of the eleventh central committee of the Communist party of China ended a long period of internal chaos and relative isolation form the outside world by announcing China's opening – an opening to the outside world and opening up of Chinese society as well. Accordingly, the National Congress approved to enact an Equity Joint Venture Law in the same year. Following the procedure, foreign-related trade laws such as foreign economic contract law of

1985, company law of 1993 and foreign trade and investment law of 1995 was enacted.

In China, the central government stipulates only a main framework of the investment policy cum investment incentives. But special preferential policy can be determined by municipal level. More precisely, municipal government is able to provide special fiscal incentives to investors within the framework of provincial taxes. Decentralization policy is well functioning in China that each municipal government compete each other to attract foreign direct investment.

1) Investment procedures

Investment procedures in China are common in all regions. However, necessary steps to be taken are sometimes differs from project to project and nature of businesses.

In order to serve investors of smooth licensing and registration procedures, each municipal government establishes centers and semi-governmental organizations, such as below:

- One-stop service Center at Shenzhen Municipal Government
- Dongguan City Consultant & Service Center for Foreign Investment at Dongguan City
- One-stop service hall at Guangzhou City Municipal Government

2) Examination of investment application

According to the guidance set out by the central government, examination and approval should be made within 30 working days from the day of receiving the relevant application documents. However, each municipal government is trying to shorten such approval period to convey a good impression to investors.

For example, Shenzhen Municipal Government expressed that they will make approval within 5 working days in case that everything is in order. Guangzhou City Municipal Government also expressed that they may complete approval procedure within 10 working days in average.

(2) Investment promotion

1) Organization

In China, Ministry of Commerce of the Central government is responsible for formulating national policy for foreign investment in view of nation based economic development. Ministry of commerce has set up and given notice of basic framework to each regional government in the form of laws, regulations and guidance.

According to these laws, regulations and guidance, each regional government has set force their own promotion policy and strategy in consideration of their location, comparative advantages and weaknesses and development plan. In that sense, detailed promotion policies and strategy is actually formulated by each regional government and much depended on own discretion of each regional government.

For example, Shenzhen City, China's first special economic zone, have their own development plan and strategy to encourage foreign investment to build a hi-tech city, modern logistic hub, regional finance center and a high cultural and ecological city after over 20 years of development experience of the special economic zone.

2) Basic policy

Basic policy for encouraging foreign investment is regulated in the "Provisions on Guiding the Orientation of Foreign Investment (Feb.11, 2002)" and "Catalogue for the Guidance of Foreign Investment Industries (Apr.1, 2002)" which were set up by the central government.

The industries to be encouraged, restricted and prohibited by foreign investment are designated in this regulation and guidance,

Under these regulation and guidance, each municipal government has set up their own policy for investment promotion, such as encouraged industries to be invited or industries to be restricted under their policies.

3) Criteria for approving investment

According to the China's investment law, foreign investment is categorized into the 3 patterns; such as Sino-Foreign Equity Joint Venture (share of foreign investment is 25% or more), Sino-Foreign Cooperative Joint Venture (share of foreign investment is 25% or more, and Wholly Foreign-Owned enterprise (100% owned by foreign).

The criteria for approving foreign investment are regulated in the "Provisions on Guiding the Orientation of Foreign Investment (Feb.11, 2002)" and "Catalogue for the Guidance of Foreign Investment Industries (Apr.1, 2002)".

- The encouraged and permitted projects with total investment (including capital increase) of US\$ 100 million and above and restricted projects with total investment of over US\$50 million and above in Catalogue for Foreign Investment and the project specified as subject to the examination and approval of relevant departments of the central government shall be approved by the relevant department of the central government.

- Other projects are subject to the approval of the relevant municipal governments, except those projects with total investment of less than US\$30 million, which is able to approve by the relevant district governments.

4) Incentives for foreign investment

In order to encourage foreign investment, the following preferential treatments are prepared as incentives by the relevant municipal government with approval of the central government.

- (a) Preferential taxation
- (b) Preferential treatment for investment to specified regions
- (c) Preferential treatment for investment to the specified projects
- (d) Preferential treatment in the bonded zone/special economic zones

For the details, please refer to the attached “Preferential Treatment for Foreign Investment (in Guangdong Province)” ,

- For the investments to the mid-west regions, some additional preferential treatments are prepared for investment area and conditions of establishment.
- For the investment to the emphasized projects to be encouraged, such as energy, transportation, special treatments for minimizing business risks are prepared
- Preferential taxation are introduced for the investment to the special economic zones (SEZ: 4 zones in all china including Shenzhen), the economics and technological development zones (54 zones in all China) and the hi-tech industry development zones approved by the central government.
- In free trade zones (FTZ: 15 zones in all China) and export processing zones, enterprises can go through, process and store imported goods without paying custom duties and taxes.

These incentives are able to enjoy after obtaining approval of foreign investment, registration of enterprise and relevant business licenses.

Competent Authorities to apply: The competent division of the relevant municipal government (Bureau of Foreign Trade and Economic Cooperation etc.,) or the relevant Bureau of Custom in case of the Free Trade Zones)

5) Other incentives

The above incentives are regulated and officially announced to public and supposedly, there is no other incentive. However, in order to encourage foreign investment, many

invisible incentives are actually offered to foreign investor by municipality under their own discretion.

(For example, in the case of Auto-City project in Huado District of Guangzhou city, Huado district government has invested to not only industrial area but also residential and recreation facilities to attract foreign investor who is considering to invest to this project site.)

(3) Promotion activities at municipal level

Investment promotion is carried out by the relevant competent division of each regional (municipal) government in charge of investment licensing by their own policy/strategy and manners.

(4) Special Economic Zones

In beginning of 1984, the government of China expanded economic zones to eastern coastal cities. The government opened SEZs at 12 cities out of 14 open-policy cities and 14 national level industrial economy development zones in big coastal cities. National level industrial economy development zones are the territories which are developed at the coastal and non coastal economic-open cities. In these areas, the government focuses on developing investment preferable conditions in both hardware and software which means fiscal incentives and investor friendly public services. These are the most characteristic development method for SEZs in China.

Information on incentives, infrastructure development, utilities, cost of initial investment, investment relating laws, investment procedures and investment gateways are fully obtained through the official website. And well developed information network like broadband enables to promulgate promotional message and information to potential investors.

In addition, major municipal government develops their own industrial zone to attract investors with special incentives. Automotive-industry-intensive industrial estate in Huadu district of Guangzhou city is one of good example. Huadu District government developed a special industrial zone to provide special preference to automotive industry. The government established an automotive technology collage to provide quality technicians to manufactures and constructed recreational parks, hospitals, shopping towns, residential buildings and utility facilities to promote auto industries. Investment procedure for investment registration and post registration will be able to complete almost half a period than any other service centers in the country. Competition among municipal government provides special and high quality non-fiscal incentives to investors.

(5) Taxation

Like many developing countries, China has undergone its own process of fiscal decentralization. This means fiscal incentives can be independently regulated by each municipal government.

Taxation system of China is summarized as below.

- Foreign-invested companies basically subject to tax 33%, composed of 30 % national tax and 3% local tax.
- But, in order to promote foreign direct investment to China, preferential taxation such as tax holiday and tax reduction is applied. Each economic liberalization area has its own fiscal incentive scheme. Foreign investors are able to compare one SEZ to another in terms of fiscal incentives. This is known as “**fiscal decentralization and political centralization**¹” which means implications for regional inequality.
- 30% of national tax may be reduced subject to start commercial operation at SEZs, such as Special Economic Zone, Export Processing Zone, Hi-tech Industrial Development Zone and etc. Shenzhen FTZ applies 15% in terms of income tax.
- In some case, tax reduction or exemption for a certain periods is applied. This system means that tax reduction is applied after settlement of cumulative deficit from the establishment of the company (maximum 5years). However, the system differs depending upon area of company established and the type of business.
- The foreign-invested company acknowledged as high-tech business may enjoy special preferential treatment such as additional 3 years tax reduction by 50%.
- Income tax should be returned and prepaid within 15days after the every quarter.
- Final income tax refund should be filed within 4 month after the end of the fiscal year with the declaration of current tax return and settlement of the shortage or the refund of overpayment tax.
- The VAT system was introduced in January, 1994. VAT is applied to sales, processing, repair work, assemble and import of goods and levy 17% tax on income now. VAT is applied as tax-exclusive pricing method. But some cases such as High-Tec companies or investment priority businesses may apply 13% of preferential tax rate.
- According to the taxation law in China, Export transaction is exempted from VAT and the VAT paid on the raw material purchases is subject to refund. In 1994 when VAT was firstly introduced, VAT was refunded in full scale; 17%. But “Notice of the adjustment of the rate regarding to the refund of export goods” in October, 2003 decided the reduction of the tax refund rate. The tax refund rate at present is depending on the goods and also be adjusted case by case.

¹ This expression is introduced at Development Strategy and Governance Division of the International Food Policy Research Institute.

- VAT refunding period was so minimized in correspondence with the reduction of the tax rate.
- Business tax is categorized as withholding tax in China. Business tax is taxed on providing specific services, such as transportation, construction, finance or insurance, post and telegraphic communication, entertainment, transfer on intangible assets, land sales and etc. The tax rate varies from 3% to 20% depending on the services provided. The tax inclusive pricing system is applied. Further, the service which is taxed on VAT is exempt from the business tax.

4.2.4 Philippines

(1) Investment law and promotion policy in Philippine

1) Investment law

Foreign investment law of Philippines approves 100% foreign capital owned company subjecting to minimum paid-up capital of US\$200 thousand.

Basically, the government welcomes any foreign company unless it is not included in the negative list. The government sets deregulation rule to foreign investment. In addition, coverage of negative list is comparatively smaller than competing countries.

This principle is well reflected to the Omnibus Investment Code of 1987 and Investment Priority Plan: IPP(details are available through official website). Omnibus Investment Code unifies the investment preferential measures to priority industries and stipulates regulation and incentives to foreign investment. Also, it regulates roles and responsibilities of BOI and PEZA.

(2) Promotion policies and strategy

The government of the Philippines invites FDI(Foreign Direct Invest) with clear message incorporated in IPP (Investment Priority Plan). The IPP shows a strong wish of the Government to welcome FDI. This plan is drafted by BOI with various criteria as profitability, contribution to national development plan, evaluation among industrial performances, comparative advantages, production volume and long-term vision. IPP will be enacted with due approval from the President. Industrial sector enumerated in the IPP is called as “Pioneer” and allowed to receive incentives. A pioneer company is one which engages in the pursuit of agricultural, forestry and mining activities as approved by the Board; and the manufacturer, processing goods or raw materials not produced in the Philippines on a commercial stage, and etc.

In addition to the IPP, there is one clearer message called as “Omnibus Investment Code of 1987”. Omnibus Investment Code is a regulation which stipulates all the incentives and deregulation measures to investment-priority sector.

Philippine government almost liberalizes foreign direct investment into the country. The negative field is only limited to a minimum area as service industry etc. Industrial estates in the Philippines are developed to promote investment priority sectors into the country. And, in 1955, special economic zone act was enacted. Following the act, the government established “eco-zone” to allow more and attractive incentives to FDI.

1) Basic policy

Investment Priority Plan (IPP) is prepared by the BOI and issued annually in the name of the President as a government policy for investment promotion. The IPP indicates a list of promoted areas of investments eligible for government incentives in consultation with related government agencies and private sector.

According to the IPP of the year 2006, the following sector/industries are prioritized to invite foreign investment.

Agribusiness, healthcare and wellness products & services, information & communications technology, electronics, motor vehicle products, energy, infrastructure, tourism, shipbuilding/shipping, jewelry, fashion garments, machinery and equipment, raw materials and intermediate inputs in support of the activities listed in the IPP.

On the other hand, Foreign Investment Negative List is issued by NEDA under the Foreign Investment Act (RA No.7042 of 1991, as amended by RA8179 of 1996) to indicate a list of investment areas reserved to Philippine nationals, in other words, those that are restricted/prohibited to foreign investment. The Foreign Investment Negative List shall be amended once in every two years.

The Foreign Investment Negative List has two components: list A and List B,

- List A shall enumerate the areas of activities to Philippine national only by mandate of the Constitution and specific laws
- List B shall contain the areas of activities and enterprises regulated pursuant to law; such as defense-related activities, public health and morals, activities mainly engaged by small and medium-sized domestic market enterprises with paid-in equity capital less than US\$200,000 or equivalent, those which are restricted to a foreign investor and whose foreign ownership is limited to a maximum of 40% of the equity capital.

As a general rule, there are no restrictions on extent of foreign ownership and foreigners can invest as much as 100%, unless activities are indicated in the Foreign Investment Negative List.

2) Criteria for approving investment

In case of foreign investment, either corporate body or individual, registration to Security and Exchange Commission (SEC) is mandatory required in order to obtain legal status to do business in Philippines. SEC examines whether applicant's activity is conflicted to provisions of the Negative List or not, and shall effect registration within 15 days upon submission of completed requirement unless there is anything to refuse application.

With regard to the capital requirement, minimum requirements for limited company are regulated as follows unless otherwise specified in the laws;

- Share of stock should be issued at least 25 % or more of authorized capital
- Paid up capital should be at least 25 % or more of share of stock issued, and
- Minimum paid up capital should be Peso 5,000 or more,

3) Incentives for foreign investment

In order to encourage foreign investment, the following preferential treatments are prepared by each investment promotion agency as incentives.

Investment promotion is carried out by the each promotion agencies jointly and independently.

Bureau of Investments (BOI)
Philippine Economic Zone Authority (PEZA)
Subic Bay Metropolitan Authority (SBMA)
Clark Development Corporation (CDC)

Among the 4 agencies, Bureau of Investments (BOI) and Philippine Economic Zone Authority (PEZA) are playing a leading role to approach foreign investors.

The following are the case of activities currently performed by BOI and PEZA.

(3) Investment procedures

Investment procedures for registration and licensing are different between SEC and BOI/PEZA.

1) Registration to Security and Exchange Commission

Registration to Security and Exchange Commission (SEC) should be mandatory

required in order to acquire legal status to start business in Philippines. Therefore, every investor must register at SEC.

SEC shall affect registration of any enterprise applying under Foreign Investment Act within 15days upon submission of completed requirements.

2) Registration on Board of Investments (BOI)

Registration on BOI is not mandatory requirement (matter of optional by investor). Investor who is eligible to receive incentives from BOI, he may ask BOI for registration. Registration procedures are shown at official website.

3) Registration on PEZA, SBMA and CDC

Investor who invests to PEZA Ecozone, Subic Bay Freeport Zone, or Clark Special Economic Zone may register on PEZA, SBMA or CDC to receive relevant incentives. Registration procedures are as per attached.

In order to assist investor to take necessary procedures for registration, BOI and other promotion agencies prepares function to facilitate required procedures, such as One-Stop Action Center (OSAC) In OSAC, not only the staff of BOI but also representatives of relevant government authorities (Central Bank, Immigration, DOLE, SEC etc.) are stationing to receive investors request at one place. The investor can ask them for necessary help to take necessary step for investment application, except the procedure for SEC registration and matters concerned with local government.

(4) Examination of investment application

Examination of investment application made by the relevant agencies is mainly intend to examine whether the investor and the project is eligible to receive relevant incentives and conform to the IPP condition and national development strategy.

(5) Tax System in Philippine

Generally, tax is heavy in the Philippines for investors. Tax in the country is defined by the following two laws.

1. The reformation of tax law in1997
2. The custom law

(6) Category of Tax

The classification of tax in Philippine which effect on the foreign investors as follows

Table 4-3 Classification of Taxes

Category	Direct or Indirect Tax	Name of Tax
National Taxes	Direct Taxes	Corporate Income Tax
		Personal Income Tax
		Custom Duty
	Indirect Taxes	Value Added Tax
		Percentage Tax
		Stamp Duty
		Commodity Tax
Local Taxes	Direct Taxes	Business Tax
		Fixed Property Tax
		Residence Tax

- The share of tax revenue in GDP in Philippine accounted for 12.7% in 2005, while the share of tax in total revenue becomes 86.01%. This value is almost equivalent to Indonesia. Considering that the financial deficit is not so severe in Philippine than Indonesia, pressure on tax levying may be rather serious in Indonesia.
- Two third of tax revenue is covered by indirect taxes; therefore the collection of direct taxes is low.
- Philippine apply the self-assessment and claiming system for tax refund calculation and taxpayer is requested to reserve and register the book. The book must be kept for three years. This period is shorter than international standard. In Indonesia, for example, it is requested to reserve for 5 years.

(7) Tax rate

Tax rate in Philippine has been gradually descending since 1998. It was 34 % in 1998 and reduced to 33% in 1999, and become 32% in 2000. At present both foreign and domestic capital company pays 32%.

(8) Tax Payment Procedure

Taxpayer is requested to declare tax refund and pay tax within 60 days from the end of every quarter of the year. Taxpayer whose quarterly sales exceed 150 thousand peso should submit B/S and P/L which is audited by the public accountant and, comparative P/L and breakdown of manufacturing cost.

Taxpayer must file a final tax return within 105 days from the end of fiscal year and close the account to settle the balance of prepaid tax for claiming refund on overpayment of prepaid tax.

(9) Withholding Tax

Income tax is withheld from both domestic and foreign company equally. Income includes interest, dividend, royalty and etc. Generally, tax rate is 32% but interest and dividend may be exempted or reduced if approved.

There is many category of general taxes to be withheld and the tax rates of those are varies from 2% to 20%. For instance, the taxpayer must pay 5% of rental fee on the real estate and 15% of consultant fee. That is called expanded withholding tax system in Philippine. It is the same situation in Indonesia that there are many withholding tax items.

(10) VAT and Percentage tax

VAT was enforced in Philippine in 1988 in lieu of the **percentage tax**. But some tax payer still applies the **percentage tax** since he is not caught by VAT. The share of VAT payer becomes bigger by the decision of reduction of refund rates in January 1st, 2003 and November 1st, 2005, as the result of financial services at bank, electric fee and periodic products become category of VAT.

The **percentage tax** is generally levied from the taxpayer whose sale amount is less than 55 thousand peso. But domestic transport, communication, entertainment, public enterprise, bank and non-bank business is levied in fixed tax rate as 1% to 25% in accordance with their sales amount in lieu of VAT. But the tendency shift from percentage tax to VAT is current

(11) Problem of VAT refund

PEZA registered enterprises are entitled to exempt from VAT according to the tax law. A company which has a business with PEZA enterprise also is entitled to exempt from VAT. Therefore the companies are requested to claim a VAT refund. Refund of VAT delays or some case not executed because the financial deficit is large in Philippine. If the applicant requires cash refund, it takes more than 2 years in worse case. Another way to refund is to get "Tax Certificate", which can make the taxable income amount reduced and transfer to the third party only once. But the issuance of Tax Certificate is also apt to delay. It is said more than one year. This situation is worse than in Indonesia that is to say, refund of VAT and other taxes requires about one year.

(12) Custom Clearance

There are three lanes established in Philippine. That is Green lane (No document check and no physical investigation), Yellow Lane (Document Check, but sometime physical inspection after documents check happens) and Red Lane (Both documents check and

physical check mandated). There is another way upon request from importers. This is called as Super-Green Lane. The importer, who wants to use the Super-Green Lane, should sign a Memorandum Agreement with the custom office. Then importer can use the Super-Green Lane on fee basis. Only three Super-Green Lane is available in through out the country as Manila Seaport custom, Manila International Seaport for containers, and Manila international airport. The applicant for the Super-Green Lane must comply with the following conditions.

- a) There is no record of punishment for violation of the rules and same kind of punishment
- b) Importing goods must not be prohibited goods.
- c) One year experience of import transactions have already finished by the application for Super-Green lane

- Super-Green Lane fee is charged as following tariff at the basis of FOB VALUE of goods as per one declaration.

(FOB Value)	(Super-Green lane fee)
Less than US\$ 5000-	PHP 500
More than US\$5,001 and less than US\$100,000-	PHP1,000-
More than US\$10,001 and less than US\$200,000-	PHP1,500-
More than US\$200,001 and less than US\$500,00-	PHP2,000-
More than US\$500,001	PHP2,500-

- Even though using the Super-Green lane there is a possibility of physical inspection because of random check indicated by computer.
- According to the law all goods imported by PEZA should be expected physically. But this provision can not be obeyed because the lack of custom officers
- The duration to release the goods is 120 hours on the average including 4 lanes. It is the longest than any other neighboring countries in ASEAN
- The digitalization (EDI) has already finished in main ports and airports since the end of December 2005. It planed to finish in all area in Philippine by the end of April 2005, but it does not finish by now
- Post audit must be performed within 3 years from the custom clearance. Therefore the document concerned must keep for three years.

4.2.5 Comparative Analysis on Investment Climate Among Four Countries

Table 4-4 Comparison of Investment Climate

	Indonesia	Thailand	Vietnam	The Philippines
Law	New Investment Law, 2006	Foreign Business Act, 1999 Investment Promotion Act, 2001	Law on Investment 2006	The Omnibus Investments Code of 1987, Foreign Investments Act of 1991 and Special Economic Zone Act of 1995
No. of article or section	23	46	89	43, 18 and 57 respectively
Attachment	Negative list	Negative list	None	Negative list
Review of negative list	Yes	Yes	Not mentioned	Not mentioned
Equal treatment	Yes	Yes	Yes	None
• Minimum capital used	None	Yes	None	Yes
• Infrastructure investment (BOT etc.)	None	Yes	Yes	None
• The duration of investment	Yes	Yes	Yes	Yes
• Investment guarantee	Yes	No	Yes	Yes
• Settlement of dispute	No	No	Yes	No
• Incentive investment sectors and geographical areas	No	Yes	Yes (Tax incentive, Carrying forward losses, Depreciation of fixed assets, Land use incentives, and other special incentives)	Yes
• Intellectual property rights	Yes	No	Yes	No
• Investment support	Yes	Yes	Yes	No
• Investment procedure	Yes (Decentralization)	Yes (Centralization)	Yes (Decentralization)	Yes (Decentralization)

4.3 Summary of Lessons Learnt

4.3.1 Strategy to Attract Foreign Direct Investment and Improving Investment Climates

(1) Investment approval or simply registration?

BOI acts as a center for investment promotion in Thailand. Investment front desk provides abundant information covering daily life to investment procedure. In addition, decision making and implementation is speedily executed because BOI is superintended directly by the prime minister. As discussed in the first field trip report, BOI Thailand can carry out all of necessary investment procedures representing other ministries. And, investment is basically registration work rather than approval work in Thailand. This concept effects on minimizing investment procedure period. Under the decentralization situation in Indonesia, the lesson learnt from Thailand gives good suggestion to BKPM whether the BKPM can convert from investment approval to investment registration.

Or, other possibility is whether we can set up investors' option-rule for a new investment proponent to choose BKPM or BKPMD as a one stop investment action center. In this case, both BKPM and BKPMD are requested to facilitate investment-relating ministries as a center of investment.

(2) Execution of investor friendly public service

BOI Thailand represents all the necessary ministries for investment procedure. This regulation realizes under centralization policy of the country. Under the decentralization policy of Indonesia, more realistic measure for BKPM or BKPMD is conversion of "front desk function" to counterpart service desk which is on service at BOI Philippines. Counterpart-style public service can be a investor friendly measure especially for the new investment proponent.

As for a new investor friendly approach found at BOI Philippine, BOI front desk staff will coordinate investment procedures as a counterpart to investors. A new investment proponent can proceeds investment registration as well as post registration activity with BOI staff in cooperation-with-singleness-of-purpose style. Application forms issued by ministries are all available at the BOI office.

More precisely, BOI staff in one stop action center accompany with the investor for construction approval at municipal government liaison office in Manila. Investment relating departments sends their representatives regularly to one stop action center of BOI for investment works. Central bank officials and other representatives reside regularly but not

everyday. During their absence, one stop service can be continued by a hotline to these departments. In BOI, only 3 local government offices open. But, all of the local government has their own liaison office in Manila. Therefore, BOI staff is able to accompany with foreign investors to apply permission at local government office. Such investment counseling service is well functioning at BOI.

Moreover, Company establishment registration is the first step of foreign investment procedure. But business approval at BOI will minimize procedure at SEC because an application at BOI covers the one in SEC.

(3) Promulgation of good image of the country

One of the distinguishing investment promotion strategies among competing countries is “good image promulgation” at BOI Philippines. The Philippines has comparatively longer industrialization history among competing Asian countries and investment promotion laws and relating regulations have been well developed.. However, industrialization and foreign capital transfer is not succeeded because of political instability and many political turmoil in the past. Nowadays, potential investors believe that Philippine is dangerous country though existing investors denies the image is not true. Investors in the PEZA controlled estate and other Special Economic Zones (i.e.: Subic Free Port Zone) assures the safeness contrary to the image. Indonesia is the world biggest Islamic country. Muslim religion is not familiar to majority of investors such as Japan, Korea, Taiwan, Europe and others. Therefore, they afraid the religions without any definite reason though existing investors laugh at the baseless image.

(4) What is the BOI Philippines’ strategy for creating good image to the country?

As discussed in the previous chapter, BOI Philippine aware of country’s image from the foreign investors point of view. This understanding is based on the marketing approach in terms of interview to foreign investors association, foreign chamber of commerce locate in Philippine and investigation made by foreign aid group such as JETRO. Although the result of improving image is not justified in quantitative data, it is necessary for the second party group country to seat next to China.

1) Strategy to build a good image

The most important start point is to know **image of Indonesia from a potential investor’s point of view.**

The following actions are at least necessary for improving country’s image:

- Interview and or questionnaire survey to identify images at both potential investors and investors on business in Indonesia.

- Evaluate and analyze the result
- Prepare action plan to improve country image
- Evaluate and choose promotional media in terms of effectiveness
- Implement image campaign and evaluate the output

2) Strategy of China

China, as already introduced in the previous chapter, their aggressive promotion approach is well reflected in the promotional materials as well. BKPM (comparative survey) attendants has already acknowledged about promotion materials provided in China were beautifully printed in order to promulgate clean, friendly, good in living and investment viable image.

For example, there are definite difference between Indonesian investment guide and that of Shenzhen. The Shenzhen guide has clear message to transfer their wishes to welcome investors with investment preferable climate.

(5) Procedure to decide and justify IPP

Decision making procedure and justification method of IPP in Philippine is one of good lesson to be learnt by the Indonesian government.

As far as the issuance of IPP is concern, BOI is the exclusive body for drafting, evaluating and superintending. Every year, initial IPP is collected from each ministry's representative for round table discussion to combine into a single list.

BOI formulate draft lists and discuss / consul with relevant agencies to make final decision. Upon finalized, the IPP shall announce to public in the name of the President once a year.

Evaluation meeting will be opened at least 3 times.

1st step: Industrial section drafts an initial plan and is evaluated within BOI directors. BOI directors associate "inter agency committee" with leadership of NEDA (National Economic Development Agency).



2nd step: Discussed within representatives from ministries.



3rd step: Public hearing (academic expert, representatives from industry, NGO)



Approval from the President of the Philippines

Preferential treatment including fiscal incentives is determined simultaneously through the procedure. BOI coordinate the decision making procedure and administrate the IPP as sole responsible agent.

This decision making structure enables to prepare IPP effectively and swiftly.

(6) How to review the Negative list

Clear definition and transparency is strongly requested to the negative list all over the world.

Negative list in Thailand shows definite criteria and the Philippines and China as well. Clear definition between negative and positive should be urgently clarified in Indonesia. Negative list in other countries shows practical idea on how to define and evaluate domestic industries. For example, protection of domestic minor businesses is a sort of important issue for an official who has a responsibility to draft negative list. In China, officials separate minor businesses whether it is based on conventional skills or advanced technologies. And this is the criteria between negative list and non-negative list.

Again, negative list without transparency becomes barrier to minimize investment licensing procedure.

(7) How to accelerate promotion activity (increasing momentum of internal competition among local municipalities)

“Fiscal decentralization and political centralization” is the specific character of Chinese Investment Policy. This internal competition among local governments accelerates the boosting of foreign direct investment into the country as a whole. The distinctive features of investment promotion of China are summarizes as follows;

- Investment promotion is projected and achieved by each municipality, even though there is guidance given by the Central government as basic framework.
- Target industries to be encouraged is determined by each municipality under their own discretion
- Investment promotion activities are performed by each municipality under their own policy and by different manners. Therefore, it seems that there is no unified way of investment promotion throughout the whole country.

For example, Shenzhen City has their own development plan and strategy to encourage foreign investment to build a hi-tech city, modern logistic hub, regional finance center and a

high cultural and ecological city. Dongguan city had succeeded to invite electronics industry and became world famous cluster of PC components. On the other hand, Guangzhou City is now trying to invite automobile industry to become a China's Detroit. The promotion strategy is putting emphasis on the following points.

- To facilitate attracting foreign investment, each municipal government try to prepares necessary infrastructure by own strategy and financing. Since individual municipality is expert to find own preferences which helps to ensure providing local resources efficiently.
- Generally speaking, the system and procedures are well established, especially preparation of tools for investment promotion, ways of presentation and media promotion compared with that of Indonesia

More definitely, following schemes and promotion measures are referred;

1) Incentive schemes and promotion measures

- In China, the incentives are regulated by the laws and regulations, which are subject to approval of the designated authorities (municipal government, bureau of taxation and others).
- Main fiscal incentive is exemption or reduction of Corporate Income Tax and Value Added Tax for foreign investors. Moreover, there are some other incentives for certain businesses specified in the regulation as investment priority.
- Development of good living condition including security assurance is important factor for promotion. Each municipal government promulgate good image of their territory as well as promotional tools such as strategic estates through beautifully designed promotional booklet and website. **Good living condition is high priority incentive to be assured.** In China, each municipal government prepares beautifully designed and clearly printed promotional booklet. This approach to investors ensures the good image to China. One important message to Indonesia is; combining rural development and SEZ development plan seems difficult without any incentives and business potentiality of these areas.
- Investment promotion activities are performed by each municipality under their own policy and method. Each municipal government prepares their own tool for promotion and performs under their own way and expenses. Therefore, there are many differences between each municipality. Each government develops own business model with due analysis of comparative advantages and market needs to attract and compete with other

municipal government. **Municipal government does not hesitate to hire or recruit from private sector** to achieve their target plan. In planning and promotion section of each municipal government, it is not remarkable to find many quality staff recruited from private sector. **They can provide ideas and aggressive services from the investor's point of view.**

2) Investment procedures

- It is understandable that basic concept for foreign investment in Philippines is “Basically Free” and there is no severe entry barrier, such as allowing investing under registration first and low minimum capital investment. Indonesia should consider this concept to welcome foreign investor not by approval basis but **by registration basis**.
- The duration for completion of normal procedure, starting from the first submission of application until obtains of the designated license, is prescribed like as “within 30 working days” in the guidance set out by the central government. However, each municipal government has their own strategy and way to shorten such duration in order to encourage foreign investor. This is a good example to transfer licensing procedure to BKPM. If BKPM is legalized to handle registration and post registration procedure within own responsibility, **speedy procedure may be expected within a framework of investment promotion strategy.**
- Accordingly, one-stop services shall be more reinforced at BKPM.
- There are some organizations to help an investor to start business by offering consultation and representation service for registration and post registration. In Philippine, these services are handled by BOI and PEZA while it is relied on private services in China. If such service can be **offered at clear tariff system**, it can be an additional incentive to investors. In China, there is **semi-governmental investment service centers** work under cost basis.

4.3.2 Investment Climate Comparison Table

Table 4-5 Investment Climate Comparison Table

		Indonesia	Thailand	Viet Nam	Philippines	China
Investment promotion and/or licensing agents		BKPM, Ministry of Trade	<ul style="list-style-type: none"> Board of Investment: BOI: companies who wishes to enjoy incentives issued by BOI IEAT: companies who wishes to obtain incentives from IEAT Ministry of Commerce: companies who wishes only registration of the company 	<ul style="list-style-type: none"> Ministry of Planning and Investment (MPI), Foreign Investment Agency (FIA): A-group project and B-group project (over US\$40million) People's committee in each ministry (DPI): B-group project (Other than EPZ • IZ and less than US\$40million) Industry area Board of management (BOM): B-group project (within EPZ • IZ and less than US\$40million) 	BOI, PEZA, SEC (Securities Exchange Committee)	Ministry of Foreign Trade and Economic Cooperation, Municipal Government, China Council for the Promotion of International Trade (CCPIT)
Promotion activity/strategy		Fiscal and non fiscal incentives are basically not introduced now. It is expecting to introduce in the new investment law.	<ul style="list-style-type: none"> Investment approval and incentives will be allowed at BOI with full authorization Clear message for priority region and sector with incentives BOI can manage and decide all the investment relating issues based on centralization policy of the Country 	<ul style="list-style-type: none"> Geological location for export and cheap manpower encourage foreign investment although investment promotion is the most inferior among ASEAN competing countries The government focuses on developing planned area to make the best of small amount of budget. 	<ul style="list-style-type: none"> IPP (Investment priority plan) has clear message to encourage FDI Development of investor friendly and good security image campaign The government use industrial estates as a investment attracting tool to investors. 	<ul style="list-style-type: none"> China is undergoing Fiscal decentralization and political centralization policy. Municipal government compete each other to encourage FDI to their territory. Each municipal government can provide fiscal and non fiscal incentives in own development strategy.
Investment relating basic laws and regulations		New investment law: under discussion at the cabinet (it will be enacted by the end of 2006). There is no separation between local and foreign investment	<ul style="list-style-type: none"> Investment promotion law: both fiscal and non-fiscal incentives are prepared to foreign company who wishes to invest in appointed region. Foreign company act: It stipulates sectors which are not allowed for foreigners. 	Foreign Investment Law (Decree 24) (New investment law was established in November, 2005. This law is common to both foreign and domestic investment. It will be enacted in January 2006. In addition, new decrees are under formulation as of February, 2006.)	<ul style="list-style-type: none"> OMNIBUS Law (preferential tax levy system for IPP registered company) Foreign investment law (this law stipulates conditions and procedure of investment for foreign companies) 	<ul style="list-style-type: none"> The Law on Chinese-Foreign Joint Ventures Procedure for the Registration and Administration of Chinese-Foreign Joint Ventures Provisions for Labor Management in Chinese-Foreign Joint Ventures The Income Tax Law Concerning China on Sino-Foreign Contractual Joint Ventures Rules for the Administration of Employment of Foreigners in China The Law on Enterprises Operated Exclusively with Foreign Capital Foreign Trade Law of China
Duration for investment approval (prescribed duration)		Nomally, it is 8 working days if document is properly submitted	<ul style="list-style-type: none"> 5 million Bahts project: 60 working days after submission of all the documents Over 5 million Bahts project: 90 working days after submission of all the documents 	<ul style="list-style-type: none"> For registration: within 15 working days Application for licensing: 45 working days for A group project, 30 working days for B group project. 	<ul style="list-style-type: none"> As for investment registration, BOI will reply within 20 working days after receipt of due application. Licensing approval will conclude within 10 days from apply. 	<ul style="list-style-type: none"> According to the guidance set out by the central government, examination and approval should be made within 30 working days. However, if it is complying with the promotion policy of each local government, it may be complete within one week.
Duration of investment procedures and licensing		It has 12 steps and will take 151 days for starting a business (28 working days by JICA study team), it has 19 steps and will take 224 days for dealing with licenses	There are 33 steps and will take 33 days for starting business, and has 9 steps and will take 147 days for dealing with licensing/approval.	There are 11 steps and will take 50 days for starting business, and has 14 steps and will take 143 days for dealing with licensing/approval	There are 11 steps and will take 48 days for starting a business, and will take 197 days for dealing with licensing/approval	There are 13 steps for procedure and duration of 48 days in average, For investment approval, it has 30 steps and will take 363 days in average
Manpower	Dismissal allowance	<ul style="list-style-type: none"> Current severance pay and dismissal allowance scheme is too protective for employee New manpower act revises in correspondence with the request from employers since the current act is criticized as too much employee protective. Out-sourcing employment and employment condition in definite term is necessary to be reconsidered 	<ul style="list-style-type: none"> Dismissal allowance starts after 120 working days but the amount do not increase after 10 years. Maximum allowance is not bigger than "300 x daily allowance". Termination because of sabotage and/or absence without permission, offend against company rule and cause a big loss to the company is not eligible of the dismissal allowance regulation Termination because of relocation and reconstruction is subject to a premium allowance 	<ul style="list-style-type: none"> Severance pay consists retirement allowance, indemnity allowance and incentive allowance from the government. Account for severance pay starts after 1 year service and build up 0.5 months salary every year. Termination because of sabotage and/or absence without permission, offend against company rule and cause a big loss to the company is not eligible of the dismissal allowance regulation. Termination because of restructuring is subject to 1 month premium allowance per 	<ul style="list-style-type: none"> BOI register company can hire alien management staff and engineers in initial 5 years. As for the BOI registration enterprise to which the foreign capital occupies more than the majority, the foreigner is employable for five years or more. 	<ul style="list-style-type: none"> "Rules for the administration of employment of foreigners in China", May, 1996 is the principle of employing foreigner in China. In case of employment of foreigner, it is requested to obtain work permit at the labor administrative authorities of the provinces, autonomous regions and municipalities directly. In foreign capital company, severance pay, in general, is paid in the following formula: (Case: closure due to continual loss) 11 months (after 5 years) 16 months (after 10 years) 26 months (after 20 years)

		Indonesia	Thailand	Viet Nam	Philippines	China
Manpower	Labor dispute	Labor disputes have remained a serious concern for businessmen in Indonesia, because there rarely is a win-win solution to such disputes. In a move expected to bring a quick end to labor disputes, the government installed a new mechanism.	<ul style="list-style-type: none"> • Labor union needs to associate with at least 10 associates. • Labor dispute needs to follow a rule stipulated in the Manpower act. It will be settled by official mediator if the negotiation fails. If the arbitration fails, strike or lock-out starts. • Legal strike: Above case only. Any strike or lock-out except above case is regarded as illegal. • Strikes by public servant is not allowed. • Salaries during strike is not payable. 	<ul style="list-style-type: none"> • One company can associate only one labor union. • Regional conciliation board or labor office will reconcile if amicable settlement was not made between employees and employers. • Legal strike: Labor union has to transmit employers not later than 3 days before the strike. And, the strike is requested to win a consent from over 50% of associates. • Salaries during legal strike is payable. However, it is not payable in a new Manpower Act. 	In the past, labor union activity was very active. During the time, the labor union strikes so often and the employers lockout it. However, such activity become minor now and number of union members shrunked. Nowadays, both employer and employee side tries to find out win-win resolution.	<ul style="list-style-type: none"> • Labor arbitration is clearly stipulated in Labor law of 1995 January • Labor dispute is increasing every year • Article 80 of Labor law accepts to establish a labor arbitration committee within a company. In case of unsuccessful negotiation, both party can seek arbitration to a public labor dispute committee. • There are over 3000 public labor dispute committee in the country.
	Minimum wages	<ul style="list-style-type: none"> • Renewed yearly • Rp.819,100/month in JABOTABEK (metropolitan area) in January, 2006. 	<ul style="list-style-type: none"> • Representative from central government, capital and labor negotiate to decide minimum wages. 	<ul style="list-style-type: none"> • Representative from central government, capital and labor negotiate to decide minimum wages. • Minimum wages differ from region to region and type of company whether it is foreign capital or domestic capital. • Foreign capital in Ho Chi Minh: 879,000 Dong/month, Suburb of Ho Chi Minh and local cities: 790,000 Dong/month, Other area: 710,000 Dong/month (As of January 2006) 	The Regional Tripartite Wages and Productivity Boards establish the minimum wage by region and industry. Basic wage in the national capital region(as of July 2006): <ul style="list-style-type: none"> • Non-Agriculture: 300 Peso • Agriculture: 263 Peso • Private Hospital with bed capacity of 100 or less: 263 Peso • Retail/Service Establishments(employing 15 workers or less: 263 Peso • Manufacturing Establishments (regularly employing less than 10 workers: 263 Peso 	<ul style="list-style-type: none"> • Minimum wage rate is decided by each municipal government. • In Shenzhen, minimum wage is 680 Yen (as of July 2005).
	Hiring foreigners	<ul style="list-style-type: none"> • Under the current manpower act, employer is allowed to employ foreigners for a certain position and for a certain period only. • Employer is obliged to train Indonesian worker so as to replace these position. This is areason why the employment of foreigner has a period. 	<ul style="list-style-type: none"> • In 39 sectors, employing foreigners are not allowed. But, unlike Indonesian case, the specification of the prohibition is clear. • One alien can employ in every 2million Baht of paid-up capital. But after obtaining BOI lisencc, this limitation disappear. • As for work visa, it is requested to obtaing non-immigrant visa at embassy or consular office, work permission at Ministry of Labor after disembarkasion, and long stay permission at Ministry of home affair. • Work permission within 15 days is available only by reporting to one-stop service center. 	<ul style="list-style-type: none"> • Alien who works for more than 3months is obliged to acquire work-permit. • Work-permit last maximum of 3 years. • Not more than 3% of alien in total number of worker is allowed to each company. • Basically, there are no exclusive sector for alien worker. However, alien is allowed to work in special type of work where Vietnamese are not afford to. • Work visa or work-permit is not requested if it is within 15days. 	<ul style="list-style-type: none"> • Alien who wishes to work in Ph. is requested to obtain both "pre-arranged employee visa" and "Alien employment registration certificate". • Employees in BOI/Peza registered company is comparably easy to get those certificate and visa. And the visa is not necessary to extend. 	<ul style="list-style-type: none"> • Employer needs to obtain approval of alien employment permission or apply employment license of foreigners • Alien worker is requested to hold the employment visa and residence certificate. • In special field of industrial sector and specialties where the government prioritize, alien specialists may be exempted from the employment license and permit.
	Outsourcing	<p>Prevailing regulation allows:</p> <ul style="list-style-type: none"> • The subcontract of part of work to another enterprise shall be performed under a written agreement of contract of work • Work that may be subcontracted as mentioned under several requirement such as 1) the work can be done separately from the main activity, 2) the work is to be undertaken under either a direct or an indirect order from the party commissioning the work, 3)etc. • Contract based (definite period) employment is allowed maximum of 4 years. 	<ul style="list-style-type: none"> • Subcontractor, on his own initiative and at own risk, can conclude a contract without any limitation • Contract based employment is allowed only for 2years maximum. • There are no regulation on sub-contract based employment. 	<ul style="list-style-type: none"> • Prevailing regulation does not stipulate outsourcing condition. • Contract based employment has no limitation of period. 	<ul style="list-style-type: none"> • There is no outsourcing regulation. • Sub-contract based employment stipulates as follows: The Labor Code divides employment only into two types. One is "regular" and the other is "casual". An employment is deemed to be regular where the employee has been engaged to perform activities which are usually necessary or desirable in the usual business or trade of the employer 	<ul style="list-style-type: none"> • No regulation for outsourcing. • No regulation for contract based employment.

		Indonesia	Thailand	Viet Nam	Philippines	China
Land		Acquisition and possession of land is allowed only to Indonesians. Foreign entities are allowed to cultivate, construction and use of land	•Alian is not able to possess land, in principle. However, foreign company with approval from BOI or IEAT can obtain land without any definite investment ratio.	•The land use right is usually admitted for 50 years. The Ministry of Finance regulates the unit price, and the land use rate settles based on the peripheral situation of the infrastructure maintenance and the coefficient of the type of business etc.	•Possession of land by alien is not allowed.	•Possession of land is allowed only in the Government of China. Land is leased upon request and approval.
Foreign trade and customs duty	Customs duty	<ul style="list-style-type: none"> Ministry of finance concerns custom tariff such as 1)import tax, 2)Tax ratio of CEPT under AFTA, 3)preferential tariff rate in ITA under WTO, 4) Preferential tariff rate under ASEAN economic cooperation accord. Duration for exportation : 25days and 30days for importation. Terminal handling charge (as of May 2005): US\$150.- 	<ul style="list-style-type: none"> Custom bureau under Ministry of finance concerns (1)general tax, (2) preferential tax (CEPT) within ASEAN and (3) Tax under FTA. In case of import of goods, both excise tax and VAT levies. But, profit from import will not be withheld. Terminal handling charge (as of May 2005): US\$65.- Monthly based advance payment system is applied (2.5% of CIF). 	<ul style="list-style-type: none"> General Custom Bureau under Ministry of Finance and Regional Custom Department stipulates Tariff Rates Import duty consists CEPT, Preferential Tariff (applied for imports from countries that give Viet Nam a preferential tariff) and general tariff Export duty applied only for rice and a part of natural resources such as minerals. Rate varies 0 to 45% of export value. 	<ul style="list-style-type: none"> National Economic Development Agency(NEDA) concerns tariff rate, import quota Custom tariff consists Most Favorable Nation(MFN) rate and CEPT in AFTA Duration for export is 19days and 22 days for import Terminal handling charge (as of May 2005): US\$78.- 	<ul style="list-style-type: none"> State Administration of Taxation concerns planning and levying of taxes and customs. General Administration of Customs controls export and import procedures, levying customs tariff and business handlings in warehouses. It employs both general custom tariff and bound tariff rate. It takes 20 days for exportation procedure and 24 days for importation procedure. Terminal handling charge (as of May 2005): US\$66.-
	Customs clearance	<ul style="list-style-type: none"> In major overseas trading depot like Tanjungpriok, Surabaya, Semarang, about 70% of import is handled through EDI system. It will take 10 to 15 minutes. Big conflict between importer and custom office is evaluation of applied import. Also, block(refuse to receive application) of applied document because of improper HS code. 	<ul style="list-style-type: none"> Duration for export procedure: 23 days, 25days for import procedure. Duration for custom clearance when import and export is 45 minutes. In case of EDI, it is 15 minutes. Cargo inspection will take maximum of 3.5 hours. Custom clearance service is operating 24hours. EDI is available any time if requested. General trouble in custom clearance is settled within custom bureau. In case of serious trouble, it goes to tax court and or supreme court 	<ul style="list-style-type: none"> Duration for export procedure: 35days and 36 days for import procedure Duration of custom clearance on general cargo: 8 hours. And, minimum of 30 minutes for export procedure Custom services are available 8 hours every day. Since July 2005, Internet custom clearance service has started as a pilot project in Nanoi and Ho Chi Minh Troubles of custom procedure will be handled by an International Cooperation Department under Custom Bureau. 	<ul style="list-style-type: none"> For custom clearance procedure, there are 3 lanes established: <ul style="list-style-type: none"> Green: non document checked/no physical investigation Yellow: document check and physical check mandated Super green: allowed to importers who received a memorandum agreement from the custom office after due investigation process. 	
Tax levying		<ul style="list-style-type: none"> Income tax (progressive tax) (corporate tax:10~30%) Loss carried forward for 5 years Imports, industrial products and almost all the services are subject to levy 10% VAT (exports are exempted) luxurious articles are subject to levy 10~75% (sales tax) Real property tax: within 10% of asset value 	<ul style="list-style-type: none"> Normally, corporate tax is 30%. But, it is less than 15% for small scale business. Payment of corporate tax: every 6 months(in every mid-term settlement) In addition to the corporate tax, VAT(7%), specific business tax(0.11 to 3.4%), withholding tax for overseas money transfer, personal income tax(graded tax system from 0 to 37%), special tax(income from oil sales, commodity tax, land development tax and stamp duty, etc.) Duration of VAT refund: 15days for export good stand company, 30days for ordinary exporting company Tax levy system is fully digitalized 	<ul style="list-style-type: none"> Applicable corporate tax is defined clearly in investment licensing document Standard corporate tax is 28% Investment to investment priority sector and/or region is regarded as a target for preferential tax rate as 10%, 15% and 20% in 10years, 12 years and 15 years respectively Foreign capital company is regarded as a target for 5 years of carrying over of losses VAT is levied 0 to 20% depending upon goods and services. Company can enjoy a preferential tax rate: Corporate income tax exemption for 2 to 4 years and 50% reduction for a several years, starting from the company for the 1st time accounted for profit. 	<ul style="list-style-type: none"> Corporate tax is 32%. Repatriation of profit to mother company in overseas will be charged by 15% as remittance tax. 10% of VAT is imposed on sales of products, service charges and importation in the Philippines. 	<ul style="list-style-type: none"> Foreign capital company is subject to pay VAT, consumption(excise) tax, business tax, income tax for foreign investment enterprises, stamp taxes, land appreciation tax, vehicle and vessel usage and license plate tax, customs duty, import duty and etc. Corporate tax for foreign capital company: 33% (30% for state and 3% for local government)

	Indonesia	Thailand	Viet Nam	Philippines	China
Foreign investment incentives	<ul style="list-style-type: none"> • Import duty exemption/reduction treaty (final custom duty become 5%) • Tax incentives (exemption/reduction of investment duty or extension of loss contango period, etc • Incentives for export goods producers (Refund of Import duty on raw materials, Exemption of VAT, luxury goods tax) • Incentives at bonded zone 	<p>BOI is responsible for both planning and implementation of investment incentives</p> <ul style="list-style-type: none"> • BOI appoint 142 industrial sector as the investment priority sectors • Investment priority industry is subject to receive incentives (Agriculture/agrotechny, technology/human resource development business, public service business, environment protection business, industry of special objective) • Such businesses as trade and investment support office, R & D, Regional generalization headquarters, technology renovation and promotion business are subject to incentives • BOI divides the whole country into three investment districts, and gives special incentives(fiscal and non-fiscal incentives) 	<ul style="list-style-type: none"> • Planning and implementation body of investment incentives : Ministry of Investment Planning • Investment priority sector such as parts manufacturer and export orient manufacturer is enacted (manufacture of products to which 80% or more is exported, domestic agrobased products to which 50% or more is exported, production of new kinds with high-quality, high economic effect etc). • Exemption of import tariff in specific sector (macninery and eqjpmnt which are imported as a capital assets, construction materials which are not manufactured in Vietnam; Raw materials used for BOT project and "special investment priority project" or raw materalis used for production at economically under developed region, raw materials and spare parts used for the production of export orient products or raw materials and parts for machinery/electric and electronics devices production(incentives are canceled if products are not exported within 275 days) 	<ul style="list-style-type: none"> • BOI registered company applies exemption of income tax(100% from the start of operation) and additional reduction on manpower cost • Onse stop action center(OSAC) allocates representatives from various public services for investment licensing 	<ul style="list-style-type: none"> • "List of encouraged foreign investment industries² clearly indicates the investment priority sectors. Also, in order to accerelate the Western China Development Plan, the government promulgated a "List of encouraged foreign investment industries in central to western China". Investment priority industry in target 20 cities is announced in the list. • Industrial sector listed in the list is subjected to obtain fiscal incentives in corporate tax, VAT, business tax, custom duty, cost for R & D and bank loan.
Negative list (sectors which are not allowed to invest by foreigners)	<ul style="list-style-type: none"> • Current negative list is composed of six lists. • List of sectors which is not open to not only FDI but also local capital • Which is open only to lcao capital • Which is open to FDI under specific conditions • Which is open to FDI under joint venture • Which is open to only small sized domestic investor • Which is open to FDI if cooperation from medium sized or large sized firms is available <p># There are a internal guidelines which are not open to public.</p>	<ul style="list-style-type: none"> • Forein business restriction law prohibits foreign capital company to aquisit majority of stocks of a specific business (It is 43 types of business at three stages) • The amount of the minimum of the investment is limited to one million bahts. • Alien capital company is not able to possess majority of capital in agriculture, stock farming, fishery and services industry. However, manufacturing sector is not included in the regulation. • The foreign capital enterprise is prohibited the acquisition of 50% or more of the stocks of a specific business. 	<ul style="list-style-type: none"> • Foreign investment in the following sector is allowed conditionally: ①Joint venture or, contract base business operation in construction and administration of telecommunication network, consultation services, travel bureau, ②Items regulated to export a certain ratio like motor cycle. power cable for low and middle pressure, ③items requested to process of indigenou raw materials as milk based production and processing, wood processing, ④investment project implemented under the minister's decree • Share of foreign capital in JV business should be more than 30% in principle, but 20% is allowed if the government approved 	<ul style="list-style-type: none"> • Negative list is re-evaluated in every 2 years. • 100% foreign capital company is allowed if it is not listed in negative list. • In general, export orient business who exports over 60% of products can operate without any business approval from BOI. The company can register BOI directly. However, BOI registered company, in general, is requested to reduce foreign share within 40%. • Minimum paid-up capital is US\$200 thousand, but is US\$ 100 thousand in high-tech industry or company employs more than 50 local workers. 	<ul style="list-style-type: none"> • State council decree No.4, regulation for investment priority sectors, classifies 4 investment category: encourage, restricted, limit and prohibition. Detailed foreign investment in this category is enumerated in the "encouraged foreign investment industries list" • Share of foreign capital is minimum of 25% but has no upper limitation. Some industry, even if it is encleded in the restricted industry list, is allowed to foreign investment company to invest
Investment Cost	<ul style="list-style-type: none"> • Monthly wage : US\$130 for technicians、 managers(\$619:at Jakarta), minimum wage increasing ratio of 23.8% in 2001, 38.7%in 2002 and 6.8% in 2003 • Power rate: \$3.02/kVA、 (\$0.05/kWh: over 200kVA) 	<ul style="list-style-type: none"> • Monthly wage: US\$179 for technicians, US\$579 for managers. Nominal wage hike rate is 0.7% in 2001, minus 1.1 in 2002 and 2.0% in 2003. • Power rate for industrial use:US\$5.46 ~ 6.85/kW/Month、 US\$0.041 ~ 0.043/kWh(depends on contract capacity) 	<ul style="list-style-type: none"> • Monthly wage: US\$122 to 135 for factory operator, middle management: US\$770 to 899 (at Ho Chi Min) • Power rate for business use: no monthly fixed rate, \$0.05 ~ 0.06/kWh 	<ul style="list-style-type: none"> • Monthly wage: US\$ 119 for factory operator at Manila, US\$ 598 for middle management at Manila, Niminal wage hike rate:10.3%(2001)、 10.3%(2002) • Power rate for industrial use : Monthly base charge: \$16.94 + 6.73 / kW and \$0.10/kWh 	<ul style="list-style-type: none"> • Monthly wage: US\$109 to 218 for factory operator, US\$567 to 1574 for middle management in Shanghai, • Nomial wage hike rate: 11.4%(2001)、 17.5%(2002)、 10.0%(2003) • Power rate for industrial use: no munthly fixed rate, \$0.03 ~ 0.10/kWh

Source: Indonesia Investment Guide by Asean Center, Directory for ASEAN Investment Policies by ASEAN Center, Investment to ASEAN countries, 2004 by ASEAN Center, BKPM website, Result of Investment Comparative Survey by JICA Study Team, etc.

Chapter 5 Policy Recommendations and Action Plans

Chapter 5 Policy Recommendations and Action Plans

5.1 Investor's Logic: Selection of the Best Location for Investment

In making a foreign investment decision, companies evaluate a candidate location by examining relevant factors that are collectively referred to as an “investment climate.” The investment climate may be considered as a bundle of investment-related risks other than business risks based on internal factors. In other words, the investment climate can therefore be defined as a combination of contingency risks and business risks based on external factors.

At the same time, the investment climate is made up of diverse factors, e.g., “political and social factors” including political stability, public order, and health care, “economic factors” including financial policy and manpower conditions, and “institutional factors” including investment policy, taxation, and investment-related restrictions.

Among these factors that constitute the investment climate, “investment policy” should be selected as a main theme proposed for improvement under the present study as it allows the most realistic approach. Table 5-1-1 classifies the key items of the investment climate into the following three categories: 1) “(A) those that can be immediately dealt with by BKPM”; 2) “(B) those requiring coordination within the government”; and 3) “(C) those that are out of government control.” Among them, the factors classified under (A) and (B) should be covered by the present study and are more or less the same as those defined in the scope of work.

1) BKPM is not authorized to make a policy proposal and submit it directly to the cabinet for deliberation. Thus, the “items that can be immediately dealt with by BKPM” include the formulation of a reform proposal for investment approval and investment promotion activities. Then, the “items that require coordination within the government” are related to, among other things, taxation and customs clearance procedures that require coordination with the Ministry of Finance and the customs office, and labor laws and foreigners’ employment regulations. Finally, the “items that are out of government control” include political and social factors, which cannot be controlled (or are difficult to control) by the government as part of its investment policy. Thus, the items in the first two categories (i.e., (1) those that can be immediately dealt with by BKPM, and (2) those that require coordination within the government) are defined as those that can be improved by the government as part of investment policy, whereas those in the third category (“those that are out of government control”) cannot be basically dealt with by investment policy improvement.

Under the present study, improvement proposals will principally target the items in categories (1) and (2) above. On the other hand, the items classified in category (3) will be dealt with by discussing “image building” that provides a room for improvement, although they

are generally unsuitable for the policy improvement approach.

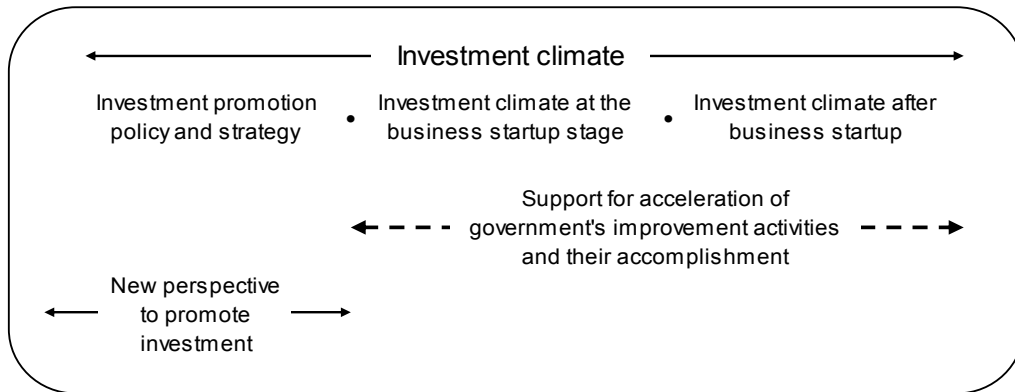
Table 5-1 Investment Climate Constituents and Scope of Coverage by Investment Policy

Investment Climate		Category
Socio-political factor	Political Condition	C
	Natural Condition	C
	Geological location	
	Whether/climate	
	Water/Mineral resources	C
	Social condition	
	Public security	
	Education	
Health care		
Economic factor	Financial policy	C
	Monetary policy	C
	Inflation rate	C
	Market scale: domestic, neighboring countries	C
	Industry concentration	B
	Business development of customer	C
	Technology level	B
	Availability of raw materials and parts	C
	Future expansibility	C
	Manpower	B
	Quality	
	Liquidity	
	Employee-employer relation	
	Investment cost	B
	Wages	
	Land cost	
	Public fees	
	Infrastructure condition	B
	Power	
	Water and sewage	
Road and harbor		
Telecommunication		
Institutional factor	Investment related laws and structure	A
	Investment promotion policy	
	Export promotion policy	
	Investment relating laws	
	Investment relating organizations	A
	Rights: target sector, region	
	Approval procedure	
Duration for approval		

Investment Climate		Category
Work		B
	Work regulation for alien	
	Residence visa	
	Labor regulation	
Land		B
	Land usage, acquisition, permission	
	Environmental protection policy	
	Land dispute	
Trade environment		B
	Customs	
	Custom clearance	
	Port charge, cargo loading cost, etc	
	Bonded warehouse	
	Handling of 2nd hand machinery	
Taxes		B
	Income Tax, VAT, withholding tax, property tax	
	Paying method	
	VAT refund	
	Depreciation period	
Policy on infrastructure		B
Foreign direct investment preferential policy		A
	Fiscal Incentives	
	Non Fiscal Incentives	
Restriction subjects		A
	Negative list	
	Ownership ratio	
	Regulation on capital withdrawal	
	Business operation duration	
	Minimum paid-up capital	
	Status of company	
	Remittent of profit and capital to mother country	
Promotion activity		A
	Investment promotion agent	
	Promotion activity	
	Advertisement and data dissemination	
Financing regulation		C
Investment agreement		C

5.2 Direction of Policy Recommendations and Basic Concept of Action Plans

Figure 5-1 Structure of Investment Climate



This chapter discusses direction of policy recommendations to be made under the present study and the basic concept of action plans to support them.

At the first step, the basic concept of the investment climate - i.e., what is required to attract foreign direct investment - is considered. As shown in the previous discussion on “the investment climate and the scope of investment policy,” the range to be covered by investment policy is embraced in the “support for acceleration of government’s improvement activities and their accomplishment” shown above. Thus, policy recommendations can be made systematically according to the above three categories. Finally, as revealed in the above classification, the improvement of the investment climate is primarily centered on institutional factors.

5.2.1 Three Aspects of Foreign Investment

Various comments are made to speculate a cause for the recent foreign investment trend that goes around Indonesia. In fact, most of them are right and make sense. Nevertheless, perception of the country’s investment climate varies somewhat according to the party that assesses it. For instance, business circles, which have to deal with problems that have cost impacts in day-to-day operation, demand the improvement of the investment climate elements that directly affect corporate profit and production cost. Solving a problem relating to business activities leads to the improvement of the investment climate, but it is by no means a satisfactory condition to attract foreign investment.

Even if a country improves its investment climate in response to the request from business circles, it will not attract foreign investment unless the improvement is made known to potential investors.

Thus, if the improvement of the investment climate is to be effective enough to attract foreign investment, it should go into government’s industrial policy and investment policy, including: 1) to help companies to overcome problems relating to business startup and implementation; 2) to remove obstacles to business startup; and 3) to provide clear incentives to attract investors while carrying out a campaign to reduce or remove a negative image on the investment climate.

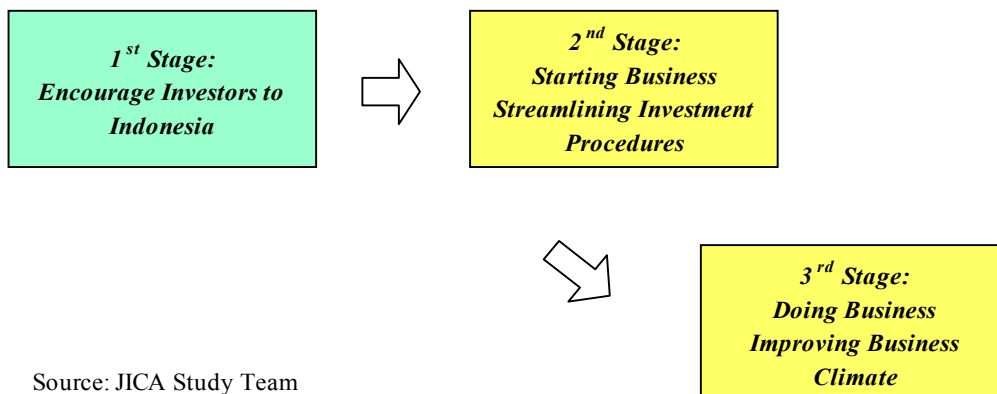
As for obstacles to business startup or implementation in Indonesia, many parties and donor organizations have made a number of proposals, and the Indonesian government is making efforts to effectuate improvement accordingly. Thus, the present study focuses on realistic policy recommendations from the viewpoint of facilitating implementation of past proposals, improving efficiency of implementation or effectiveness, rather than exploring new areas of improvement. In particular, the project scope includes effective support for the Indonesian government’s investment climate improvement activities.

Note that investment promotion policy will be conceived from a fresh perspective by learning from other countries and their experiences.

Before the principle of recommendation for the improvement of investment policy is discussed in detail, the actual composition of the investment climate will be analyzed, and then, what improvements will be required. Also, the positioning of BKPM in Indonesia’s investment climate will be defined in this chapter.

To establish an effective investment promotion strategy, it should proceed in the following three aspects to make the process logic clear. (See Figure 5-2 “Structure of Improvement of Investment Climate”) In the first aspect, potential investors make an investment decision. In the second aspect, they select an investment location and start necessary procedures including commercial registration. In the third aspect, they start business activities. Each aspect is indispensable in promoting foreign direct investment and requires key players.

Figure 5-2 Structure of Improvement of Investment Climate



Source: JICA Study Team

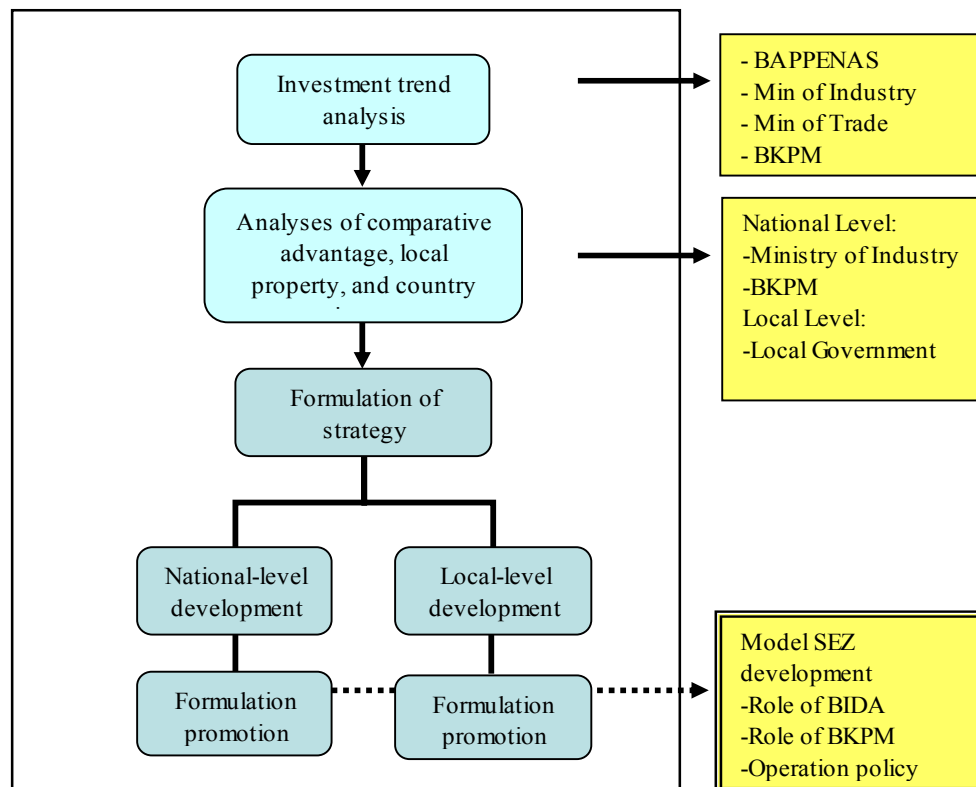
(1) First aspect

The first aspect is an essential element to prompt potential investors to decide on investment in Indonesia.

First aspect (promotional activities)(Category A,B,C)

- ◆ Clear industrial policy(A)
- ◆ Attractive incentives consistent with industrial policy(B)
- ◆ Comparative advantages for the country and each region(C)
- ◆ Local characteristics that appeal to investors(C)
- ◆ World investment trend and position of Indonesia (C)
- ◆ Past investment trend (C)

Figure 5-3 Structure of the First Aspect



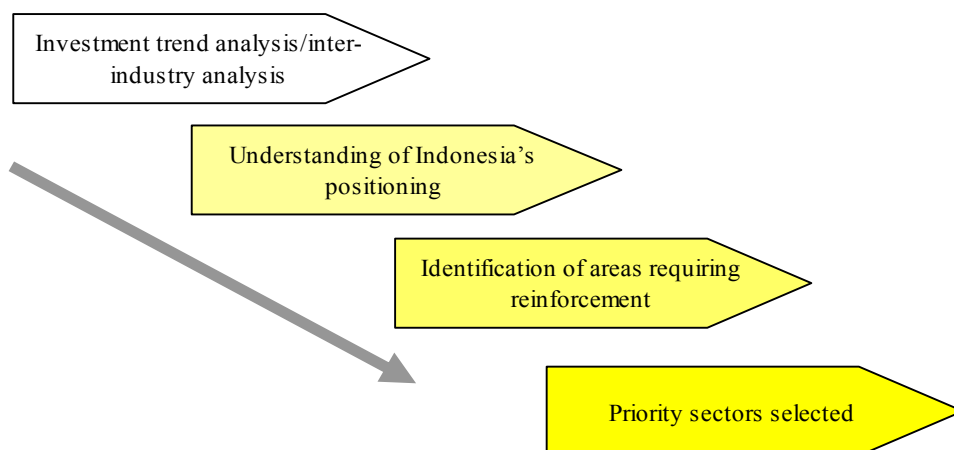
Source: JICA Study Team

1) Investment trend analysis and investment target sectors

As discussed earlier, industrial promotion policy is critical in formulating an effective investment promotion strategy. In fact, it is well known that industrial promotion policy is interlinked with investment promotion strategy. To promote investment in Indonesia, therefore, it is imperative to understand the “global investment trend” and the “Asian investment trend,” and to learn the positioning of the country in the global and regional context.

Take production of popular automobiles in Asia. China and Thailand are competing as two major production bases, which lead the development of the global sourcing system for automotive parts and components. As standardization of parts for popular models progresses year after year, the positioning of the Indonesian auto industry is governed by its comparative advantage in terms of quality, cost and delivery (QCD). To keep the advantageous position established for the country, it is important to reinforce its competitive position by analyzing its competitors (countries) in terms of strengths and weaknesses. At the same time, an aggressive approach is required to find the ways to make inroads into the market controlled by competitors. This SWOT analysis will elucidate key technologies required to improve Indonesia’s competitiveness, and “priority sectors” required to attain the key technologies in an efficient manner will be identified. Figure 5-4 shows the conceptual process flow to identify priority sectors.

Figure 5-4 Conceptual Process Flow to Identify Priority Sectors



2) Investment trend analysis relating to Indonesia (category A)

Historically, assembly manufacturers that invest in developing countries, including Malaysia, accompany first- and second-tier suppliers. China, Malaysia, Thailand and other Asian countries have adopted an aggressive promotion strategy to increase foreign investment

by focusing on a major assembly manufacturer with view to attracting its entire supplier base, including suppliers of parts and related products and services (packaging, printing, etc.). The investment trend analysis will be conducted to determine whether the above investment pattern still prevails today. If so, the investment promotion strategy should include promotional activities focusing on selected companies that can create the above multiplier effect. Also, outer shape of industrial cluster will be formed by concentrating assembler and its supporting industries into one area.

Details of the current investment trend into the Republic have been discussed at previous chapter (Chapter 2). Take only about conclusion, services sector became a big tide to Indonesia and little number of big-scale assembler, as referred at previous section, has been come to the Republic in these years. Under the circumstance, we feel a new possibility of industrial development for the point that an additional domestic investment of two wheeler production is implemented, and business performance as cost competitiveness by means of mass production was up-graded. The export expansion can be expected by strengthening business performance of local industries. Accordingly, it is requested to improve investment climate (doing business aspect) that encourage local investment urgently.

It is not realistic to expect the movement of a large-scale assembler including the movement of the supporting industry now. Then, how is the trend of other industries that can expand employment? (i) Are there any chances to accept new type business or such intellectual based manufacturing as IT based software development, 3-D design, and animation creation? (ii) How about encouraging a new concept industry into Indonesia? For example, sugarcane and coconuts growing became a highlight industry in conversion energy field. Does Indonesia have comparative advantages to lure such industry? Sugarcane and coconuts growing was considered as a labor intensive industry in the history. It became a high value added industry other than employment receiver when they used as a raw material for conversion energy.

3) Investment flow to Indonesia

BKPM, as the gateway to investment in Indonesia, stores a wealth of data and information on companies that have previously invested, by sector, the number of cases, value, as well as chronological changes. Such data can be used as an effective tool to estimate Indonesia's position in the context of the global and regional investment trend.

By analyzing the yearly changes in investment data, Indonesia's true value to investors can be revealed. The data will allow us to find what investors have been expecting from Indonesia, i.e., inventors view the country as a source of competent labor force, a large domestic market, or abundant supply of natural resources. Then, further analysis of recent changes in investment structure can reveal what they will expect in the future.

BKPM's data can also be used to analyze the investment trends by country, characteristics of invested sectors, recent trends (sectors in which foreign investment increases or decreases significantly, the amount of investment per project, relationship between foreign and local partners, etc.).

- 4) Investment trend analysis based on questionnaire survey and feedback to action plans in the following year (category A)

BKPM's foreign investment section often exchanges with potential investors in foreign countries throughout the year. In addition to promotional activities by exhibiting an Indonesian booth at trade fairs (distribution of investment guides and consultation desk), it holds investment seminars to explain the country's investment climate in detail. It also conducts questionnaire surveys of potential investors at these occasions in order to collect data and information relating to the investment trend and expectations of investors. In reality, however, information gathering and analysis has not been carried out efficiently, for the following reasons.

- (1) The questionnaire survey method (questionnaire design, analytical technique, etc.) has not been established.
- (2) There is no section specialized in analysis of survey results.
- (3) There is no system to allow the sharing of data collected in foreign countries.
- (4) For reasons (2) and (3) above, published data on potential markets are limited in breadth and depth (they can be obtained over the Internet).

More precisely, BKPM has yet to establish a formal system that defines responsibility, e.g., who designs and makes questionnaire for what purpose. BKPM needs to collect and analyze investment-related data for the following three objectives.

- (1) Selection of target countries for prioritized investment promotion
- (2) Selection of target sectors for prioritized inducement of foreign investment
- (3) Expectations and demands of investors and Indonesia's general image (to collect data that are conducive to the improvement of the investment climate)

Then, the following plans will be formulated to accomplish the above objectives.

- (1) Organization, institutional setup, and manpower assignment
- (2) Strategies by country and sector (information gathering and promotion)
- (3) Annual activities (development of promotional tools for target countries and sectors)
- (4) Project evaluation method and standard
- (5) Budgeting

Needless to say, these plans will not be made on the basis of the results of questionnaire surveys alone, but also the results of analysis of data obtained from actual investment projects and procedures.

5) Information gathering (category A)

As BKPM does not have sufficient information blushed by counterpart organizations in other countries as well as international organizations, its investment strategy is based on a fairly limited amount of information. It cannot understand the investment trend accurately and is incapable of preparing effective promotional tools at foreign exhibitions and business seminars. Furthermore, information obtained by various personnel from potential investors and other organizations is not shared with other BKPM employees. In particular, BKPM fails to share the following information.

- (1) Information on Indonesia's investment climate that potential investors wish to learn
 - (2) Impeding factors for potential investors to invest in Indonesia
 - (3) Indonesia's comparative advantages perceived by potential investors
 - (4) Target markets for potential investors when investing in Indonesia
 - (5) Expectations for the Indonesian government relating to investment, e.g., consulting service relating to investment procedures, introduction of potential business partners, provision of detailed information relating to the investment climate, provision of information on the investment law, and available incentives.
 - (6) Other useful information provided or published by counterpart organizations
- 6) Effective use of local resources for foreign investment projects

Key points in promotion of foreign investment in Indonesia are global market opportunities and technology trends relating to agricultural and mineral products as well as new products using the former as raw materials. Specifically, BKPM must understand as to what is required to convert resources and assets peculiar to Indonesia to high value added products, who possesses technology to enable such conversion, and what the technology company's investment strategy is.

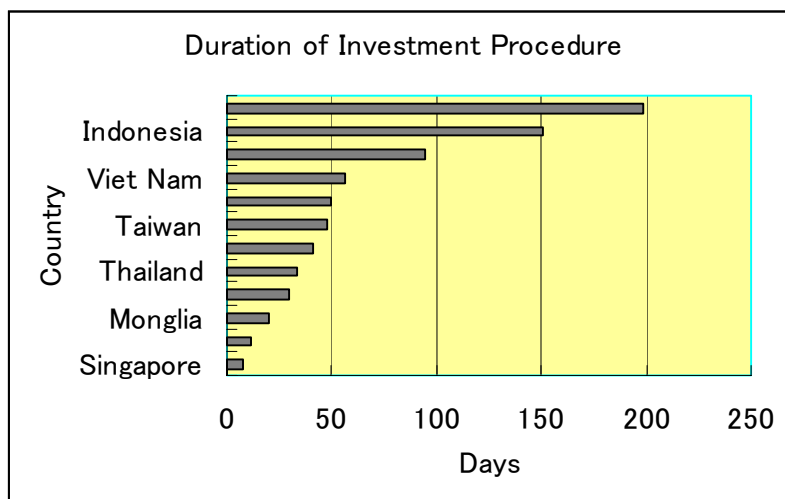
Based on the above understanding, BKPM will be able to identify fiscal and non-fiscal incentives to be provided by the Indonesian government.

(2) Second aspect

The second aspect primarily consists of investment procedures for starting business. Previously, the World Bank published a report telling that it would take 151 days for the investment procedure in Indonesia, which created a great shock for the government and related parties. Although the result was later modified to less than 100 days by a study team

of an Indonesian university, the duration is still much longer than that in neighboring countries, such as Vietnam, Thailand, and the Philippines.

Figure 5-5 Duration of Investment Procedure



Source: Ministry of Trade

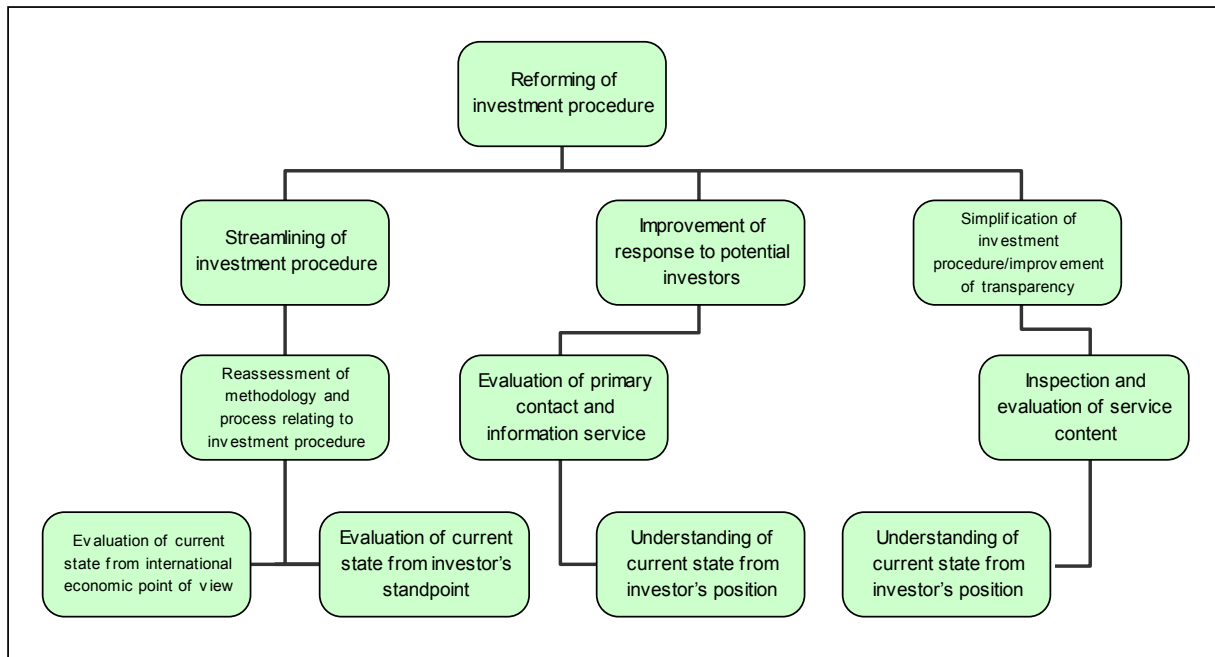
In fact, the duration of investment procedure is governed by a variety of factors, such as uncertainty about the negative list, issues relating to the transition to integrated service under one roof or delegation of authority within each ministry or agency, and a large number of approvals and permits under jurisdiction of local government. To shorten it significantly, therefore, a number of problems have to be overcome. As BKPM is the government office serving as the gateway for the investment procedure and authorized to issue a permanent business license, it is undoubtedly a key player, both at the beginning and end of the procedure. In reality, however, local government handles much more approvals and permits (including business licenses) than the central government does. Besides, there are substantial variations in handling capability and responsiveness among local governments.

The general flow of the investment procedure and procedure-related issues are already discussed in Chapter 2. Here, the general direction of improvement at this aspect can be roughly divided into the following three items.

Second aspect (Starting business)(Category A,B)

- ◆ Improvement of transparency of investment procedure (A)
- ◆ Improvement of investment procedures and responsiveness (investor friendly)(A)
- ◆ Streamlining of investment procedure(B)

Figure 5-6 Second Aspect



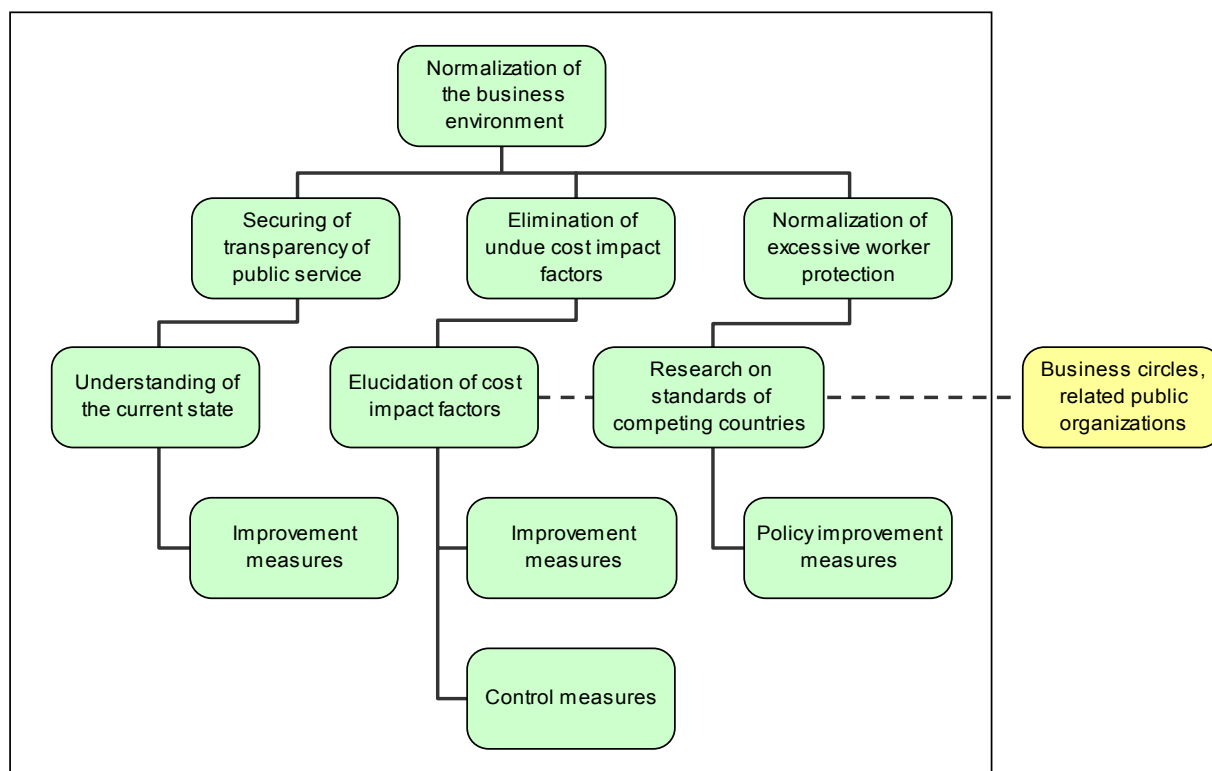
(3) Third aspect

The third aspect represents actual business activities. Any obstacle or problem that can prevent normal business activities should be promptly addressed and seriously dealt with. Otherwise, it can become a major impeding factor for foreign investment.

Third stage (doing business)(A,B)

- ◆ Obstacles and problems to be overcome for normal business activities(B)
- ◆ Lack of transparency of relevant systems and institutions(A,B)
- ◆ Cost impact factors relating to customs, taxes, industrial relations, wages, infrastructure, etc.(B)

Figure 5-7 Third Aspect



Source: JICA Study Team

The improvement of this aspect is underway as detailed discussion is made on 118 investment climate improvement action programs developed under the initiative of the Japanese embassy in Indonesia and on the basis of the results of JJC's questionnaire surveys of its member companies as well as activities of subcommittee meetings. (Details of each action plan, such as target, the planned duration to accomplish improvement results, the implementation body, and the progress status, are summarized at the end of this report.)

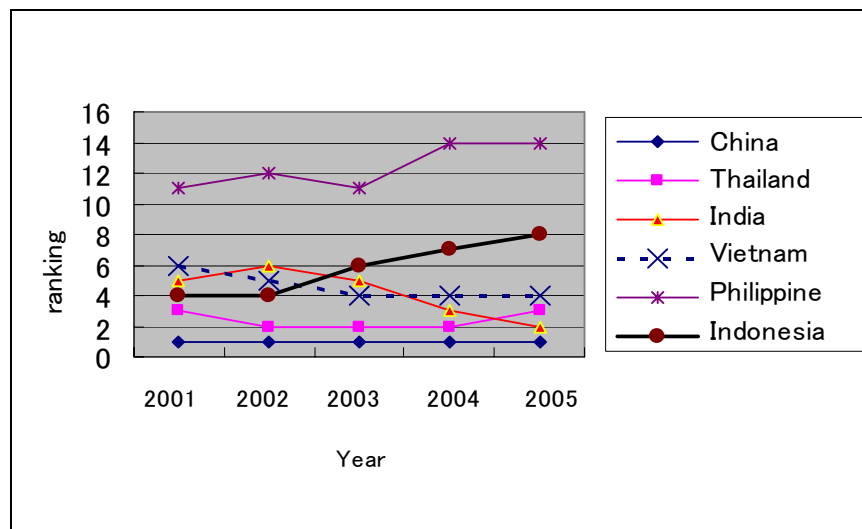
After the completion of the IMF program at the end of 2003, donor countries and international organizations formed the Consultative Group for Indonesia (CGI), which is active up to now. In line with this initiative, the Japan-Indonesia Public-Private Joint Forum was formed for the purpose of proposing specific action plans. Then, an action plan for the improvement of the investment climate in Indonesia (SIAP) was proposed under the leadership of the Japanese embassy in Indonesia and the Jakarta Japan Club (JJC) in order to follow up the progress of the improvement initiatives. To this date, 118 action programs have been submitted and their progress is being monitored. Finally, the draft proposal for the new investment law was submitted to the national assembly in June 2006 and is considered to be consistent with the SIAP in terms of concept.

The results of interview surveys conducted so far indicate that few investors expressed

opposition to the SIAP's concept and a general outline of the new investment law. In fact, most of them expected that the ministerial decree or similar order would be issued as early as possible. If the new investment law is enforced according to its original intention and concept, it will change the country's investment climate significantly. This is because the SIAP has been developed to address various issues relating to the investment climate, which were reported from actual business experience.

If the SIAP is implemented properly and the investment climate is improved appreciably, the news will soon be known to potential investors through trade organizations such as JJC and the Federation of Economic Organizations. However, reversing the investment trend that goes to rivaling countries back to Indonesia requires a more aggressive strategy. As indicated in actual investment data, Indonesia receives a very poor evaluation as the place for investment, not to mention the IFC's Investor Friendly Ranking (Figure 5-7). (The country's ranking in terms of the prospective country for investment deteriorates steadily.)

Figure 5-8 Prospective Countries for Investment in the Medium Term, as Perceived by Japanese Companies



Source: JICA Study Team, Based on data by "2005 JBIC Institute"

In addition to the announcement by the World Bank on the long duration of the investment approval procedure, Indonesia has experienced several events that serve as "negative promotion," namely terrorist attacks by Muslim extremists and the major earthquake and tsunami that caused devastating damages. Furthermore, the Indonesian government itself seems not to be highly aware of the effect of such negative promotion, e.g., government officials continued to refer to the World Bank's report on the long duration (151 days) of the investment procedure, despite the fact that the bank announced a shorter period later.

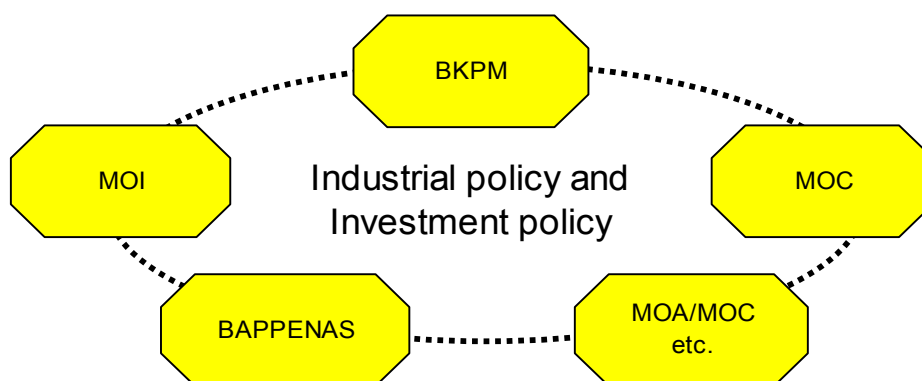
While the acceleration of the investment climate improvement efforts is the necessary condition to promote foreign investment in the country, a proper mechanism is required to translate improvement results to actual investment. Also, further proposals can be conceived with respect to the method to materialize and accelerate implementation of improvement measures contained in the SIAP that is currently under discussion.

5.2.2 Investment Promotion and Industrial Promotion Policies

Investment trend analysis and industrial analysis using BKPM's proprietary data and information produce critical data required to formulate the country's industrial policy, also allowing the development of an effective investment strategy.

Indonesia's investment promotion policy is developed on the basis of the national development guideline (Medium-term Development Plan 2004 – 2009) and in line with the national industrial development strategy, the commerce and service industry development policy, and other relevant policies. At the same time, investment trend data are used as the basis of formulating the national industrial development strategy and the commerce and service industry development policy. Thus, there are interdependencies between line ministries that are responsible for the above policymaking (see the figure below).

Figure 5-9 Interdependency between BKPM and Line Ministries



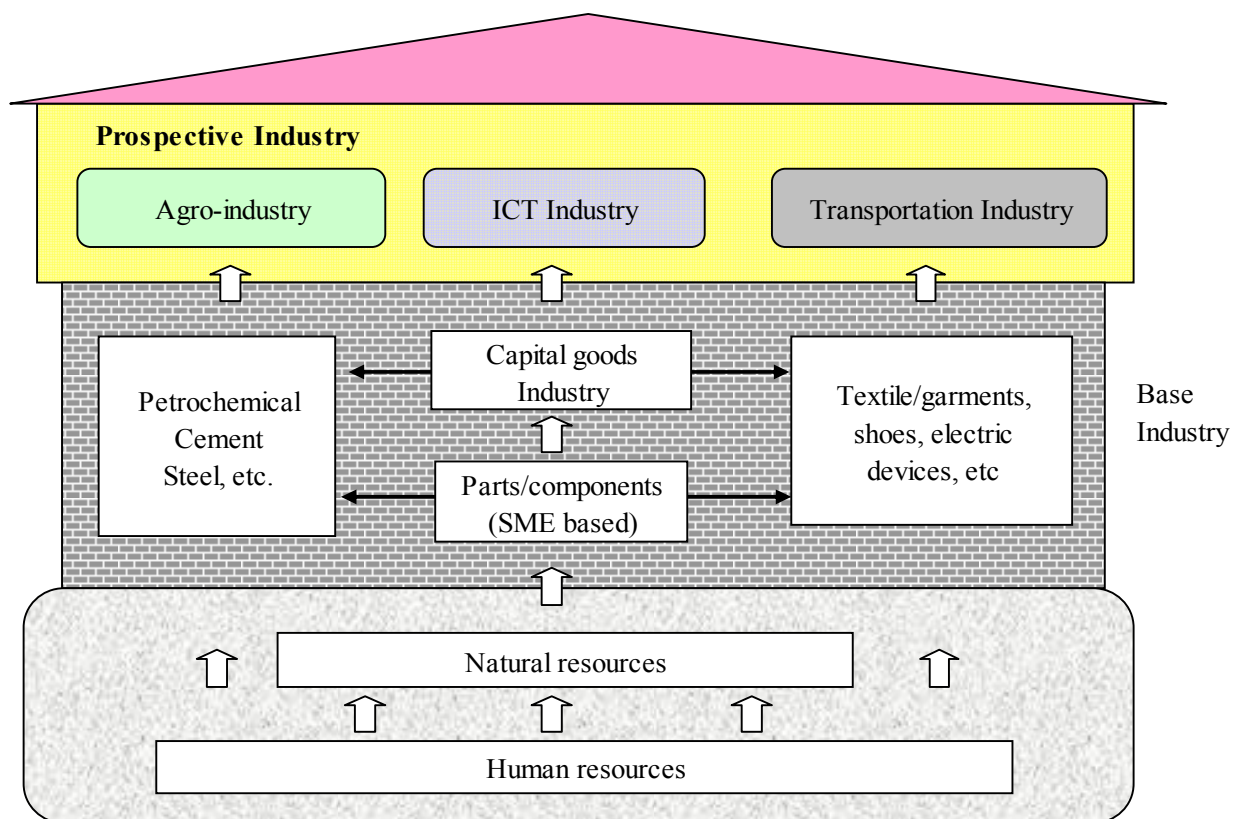
(1) Development of industrial policy

The government's industry policy formulation is founded upon BAPPENAS's Mid-term Development Plan (2004 – 2009), which thus serves as the guideline for the Ministry of Industry. In reality, however, the MOI is often criticized for the lack of strategic focus in its industrial development/promotion policies as it gives excess consideration to trade associations and their requests, while it is aware of importance of objective criteria for such

priority setting, such as economic efficiency, global investment trends and the positioning of Indonesia, and the country’s comparative advantages. In particular, neglecting the criteria means that the MOI is unable to pursue economic efficiency that can be maximized by promoting the right sector.

At the same time, the MOI intends to promote industrial development through the facilitation approach under “industrial cluster development policy,” which reflects the notion that the traditional government-led industrial development policy is the thing of the past. While it is understandable that the MOI advocates the cluster development policy that represents the current mainstream thought about the industrial development process, it fails to present a clear road map for an ultimate goal, e.g., which industry will be promoted, while the industrial cluster policy involves a number of players, including priority clusters, core industry clusters, industry groups that support the core industry cluster, and SMEs (Figure 5-9).

Figure 5-10 Conceptual View of MOI’s Industrial Development Policy



Source: Ministry of Industry, Industrial Development Policy in 2005

1) Industrial development and BKPM

- ◆ BKPM is only one government organization specialized in investment.
- ◆ It has weakness in analysis of investment trends.

While BKPM is the sole organization that is responsible for integrated management of information on investment in Indonesia, it does not use the information resource in an effective manner. As a result, it does not provide accurate information on the latest investment trend for the MOI. For instance, BKPM does not analyze key information useful for the MOI and the MOC in their industrial policy making, such as the global investment trend and Indonesia's position, and the trend in propensity to invest in Indonesia.

2) Investment development policies closely related to the formulation of investment promotion strategy

- ◆ The current industrial development policy lacks a strategic focus and it is doubtful if it serves as a clear guideline for selection of priority sectors.

As discussed earlier, Indonesia's industrial development strategy is criticized for its failure to set a strategic focus. Which sector should be given of priority for promotion, i.e., which sector can produce the highest benefit as a result of public support, seems to be discussed from the viewpoint of needs, rather than economic effect. This is evident from the fact that most industry sectors in the country can be listed as priority sectors for investment. This makes it difficult to develop a focused investment promotion strategy. If priority sectors are selected according to the objective criteria, proper incentives can be provided to divert investment to such sectors by sending a clear message to investors and other related parties.

The MOI's basic concept on the national industrial development policy and selection of priority sectors is presented at the end of 5.2.2.

3) Investor's logic used for selection of investment locations

- ◆ Evaluation of candidate regions/areas in Indonesia from the investor's perspective
- ◆ Evaluation of comparative advantages at national and local levels to see if they accord with the investor's perception

Companies select a location that offers the highest return on investment from global perspective. In other words, companies, as private investors, make their investment decision by evaluating feasibility, i.e., which location offers the highest advantage.

For instance, a region which offers a high labor cost advantage can attract labor-intensive investment, while a region with high industrial concentration is attractive for manufacturers that can benefit from procurement of parts and materials from the region. Similarly, a region with rich natural resources draws companies that are their major consumer.

On the other hand, from the host country's perspective, the most realistic and desirable approach is to leverage the country's or the region's comparative advantage.

4) Industry's international competitiveness (productive performance)

◆ The objective of industrial promotion is to assist companies in gaining productive performance.

Companies are exposed to intensive competition in the global market. To ensure that their products establish and maintain competitiveness in the highly competitive environment, they must keep comparative advantage in terms of productivity, quality, service, market responsiveness, quick innovation, and other factors. Gaining such comparative advantage in the market (productive performance) is the key to the company's sustainable growth, and the primary objective of industrial development is to help the country's industry to achieve productive performance.

5) Secondary effect of investment

◆ The spillover effect of technology and management know-how is a major benefit of foreign investment.

As companies are an economic unit to earn profits from business they operate, production cost control (minimization) is their mandate from the corporate governance point of view. For companies to make a successful overseas business, the use of human and physical resources in a host country – whether they are required to use them by the country's law or not – is a rational option so far as they are readily available with good quality. Furthermore, the use of human resources allows smooth business operation and technology transfer to the host country.

However, the effective use of local manpower in Indonesia is impeded by the government's unduly labor protection policy. In particular, the severance pay is way over the Asian standard and long-term employment is said to create heavy financial burdens on companies. As a result, companies opt to dismiss employees after a relatively short period of service, thereby prohibiting technology transfer to employees, not mention the fact that not many employees work under a long-term contract.

Positive impacts of direct investment by foreign companies – regardless of their objective (acquisition of ownership or the establishment of a local subsidiary) – are not limited to job creation, but the development of support industries including parts suppliers, and the encouragement of competition. Equally important is the spillover effect of technology and management know-how that are brought by the foreign company to the host country.

6) Unclear definition of priority sectors for industrial promotion

- ◆ As no clear demarcation is made between priority sectors and priority clusters, the two segments are difficult to distinguish and tend to be viewed as a single target for industrial promotion.
- ◆ Collaboration with BKPM, which is the front line of foreign investment, is essential.

The MOI, responsible for selection of priority sectors for industrial promotion, formulates the industrial development strategy according to the basic concept of the medium-term national development strategy and potentiality of industry groups. Based on the development strategy, industrial development action plans are developed. For implementation of each action plan: (1) a task force is organized; (2) an activity plan is prepared; and (3) a budget proposal is prepared. Then, indices to measure the results are established for each activity plan. Accordingly, the results are evaluated to make the MOI accountable for budget execution and management. Finally, issues relating to implementation of each action plan are analyzed and recommendations are made for planning and implementation of the subsequent activity plan.

Thus, the process - from the development of the action plan to the evaluation of the results – is logical and makes sense. Within the MOI, selection and promotion of priority sectors in terms of methodology is clearly defined. Yet, its selection of priority sectors and promotion strategy appear to lack a strategic focus in the eyes of foreign investors for the following reasons.

Within the MOI, voices are heard to criticize that the present selection of priority sectors tries to please everyone, especially in response to requests of trade associations, while the MOI pays attention to the economic effect of industrial promotion. Basic strategies incorporated into the MOI's development strategy - i.e., the strengthening of the value chain, the development of priority clusters, and decentralization of industries to regions that produce natural resources – are fairly logical and acceptable. Nevertheless, no incentive is provided for investment in any of the priority sectors, certainly not appealing to investors. And BKPM has not made any industrial development policy proposal from the investor's perspective.

Most industry sectors undergo evolution of production styles and processes due to advancement of technology and logistics. Under these circumstances, the industrial promotion strategy deviates from reality unless the global investment and industry trends are properly analyzed. This necessitates close collaboration with BKPM that serves as the primary contact with foreign investors.

National Industrial Development Policy and Selection of Priority Industries

A policy paper published by the MOI in 2005, based on the recognition that adequate efforts to use the country's all resources as well as domestic and foreign opportunities are required to build the country's sustainable international competitiveness, has measured industry's competitiveness from the viewpoint of both supply and demand and has selected promising industry groups. To accomplish the goal, it sets forth the following development principles: (1) development that envisages sustainability and environmental protection; (2) optimization of use of local resources; (3) minimization of strategic reliance on external strengths; (4) equalization of role, treatment and opportunity relating to business implementation and the attainment of business results; (5) prioritization of more people-oriented initiatives and participation to support realization of economic activities based on broad public interest; (6) collaboration and synergy of domestic potentials in the wake of facing global competition; (7) prioritization of national interest over the sector's or region's interest; (8) global economic partnership to bring about mutual interest without injuring national interest or sovereignty; (9) improvement of efficiency and productivity, and preservation of resources to achieve the maximum development benefit; and (10) commitment to capability, professionalism, competition and innovation.

Based on the above principles, the MOI establishes medium- and long-term development objectives. To achieve each objective, it claims that it has selected industries having international competitiveness and high growth potential as priority industry sectors. Note that industries with high growth potential mean those that have high levels contribution in terms of growth opportunity, domestic economy, and employment capability.

The industries selected for medium-term industrial development include the following sectors: (1) food and beverage; (2) marine product processing; (3) information technology, communication equipment, telecommunications (ICT); (4) manufacturing base; and (5) selected SMEs. On the other hand, medium-term industrial development under National Medium-term Development Plan (Presidential Decree No.7 of 2005) focuses on core industry clusters, which include: (1) food and beverage; (2) marine product processing; (3) textile and garment; (4) footwear; (5) palm tree; (6) wood product (including rattan and bamboo); (7) rubber and rubber products; (8) public and paper; (9) electric machinery and equipment; and (10) petrochemical.

The government seems to differentiate development of priority industries from that of core industry clusters. It fails to make a clear message to potential investors by showing a clear focus on its investment promotion policy.

In a sharp contrast to the Indonesian government's ambiguous position toward priority sectors, the Philippines offers clear incentives to priority sectors under Investment Priority Plan (IPP) that has been established pursuant to the Omnibus Law.

(2) Augmentation of the synergistic effect by coordination between investment promotion and industrial promotion

◆ Continuity between industrial policy and investment policy is essential.

To ensure the maximum effect of industry policy, it must be planned and implemented in consistency with investment policy, and vice versa. In today's relentless economic globalization accompanied by rapid technological advancement, companies are required to face strong competitive pressure from foreign products. At the same time, many companies establish and reinforce alliance with foreign companies in the form of OEM or supply of parts. Intensive competition on a global scale prompts companies to make continuous efforts to improve competitiveness, and reduction of production costs constitutes a critical element. Foreign direct investment, which is intended for relocation of production bases, is decided as part of such corporate strategy in an effort to leverage comparative advantage or competitive advantage of the host country.

As business activities are founded upon profitability, companies make an investment decision wherever it makes a sound business case. This is a winning formula for any company to invest in the environment that offers a significant comparative advantage. Industrial development policy is a major policy instrument to develop such advantageous business environment, and investment promotion is a mechanism to ensure a high return on investment by using the business environment as a promotional tool.

At present, economic revitalization using job creation and industrial development is a major pillar of Indonesia's national development policy. Roles of investment policy and industrial policy should be examined and defined in line with this policy direction.

(3) Elements effective in promoting job creation

◆ Close association between the economic effect brought by investment and the industrial development plan

Increase in the number of companies

Promotion of foreign investment

- Promotion of domestic investment:
- a. revision of laws and regulations relating to incorporation (reduction of paid-up capital requirements and simplification of procedures)
 - b. Creation of new businesses through promotion of interaction between companies

in different industries

- c. Fostering of new investors through the business incubation mechanism
- d. Strengthening of mutual support by promotion of industrial concentration
- e. Promotion of industrial-academic joint development projects (the Indonesian version of Silicon Valley)

Revitalization of existing companies: f. Development of products under the new concept through the interaction between companies in different industries

- g. Strengthening of existing companies through implementation of institutional lending
- h. Provision of non-fiscal incentives for industrial estates and other areas having industrial amalgamation (such as priority allocation of utilities)
- i. Increase of employees in long-term contract through the revision of the law relating to the severance pay
- j. Cost reduction through the improvement of physical infrastructure
- k. Human resource development (upgrading of worker's skills and management skills)
- l. Strengthening of local technical support organizations
- m. Others

Thus, for expansion of employment opportunities alone, a variety of approaches are feasible, including programs to encourage new business startup, to increase employment opportunities through the strengthening of existing companies in terms of financial base and/or business performance, and to support development of new product/business concepts.

(4) Development of local industries by inducement of foreign investment

- ◆ Development of supply and demand sides
- ◆ Expectation for the spillover effect

Among industrial development programs to revitalize local industries, it is imperative to

identify those that can help augment business advantage for potential investors. In fact, all programs can create some forms of business advantage - directly or indirectly – for foreign companies, because the improvement of the business environment for local companies is also desirable and applicable to foreign companies, although the level of important is by no means uniform.

Foreign companies can also play an important role in improving business performance of local companies. They are not necessarily competitors but can establish mutually beneficial relations with local companies by purchasing parts from local suppliers, and vice versa.

Furthermore, foreign companies can be used to make effective use of locally available natural resources, technology and/or capital or to commercialize value added products, so that local companies do not have to start from scratch.

Foreign investment can also be used to supplement or reinforce competitiveness of local industries by serving as supplier or customer. More precisely, foreign companies can serve as a yardstick to measure competitiveness of local companies. A possible approach is to analyze competitiveness of fast growing industries in Indonesia and to attract foreign companies that have the high level of interdependency with the local industries (either as customer or supplier).

5.2.3 Improvement of Investment Climate and BKPM's Position

BKPM's target -- potential and prospective investors, as mandated in its mission and activity – does not entirely agree with that set by the Public-Private Sectors Joint Forum. While the forum's recommendations do not necessarily reflect improvement proposals submitted by individual companies, it is true that they focus on actual business activities.

The improvement of the poor investment climate that interferes with business activities and the promotion to advertise the good investment climate should be principal activities to attract foreign investment in Indonesia. Also important is the development of an effective promotional tool that encourages favorable investment decisions.

In summary, key activities that are conducive to promotion of investment include: (1) solution of problems relating to business activities (policy support to help maintain normal business activities); (2) the buildup of a mechanism to help business activities in the country to reduce costs and to improve competitiveness (wage, export/import, and entry to the local market); (3) development of better promotional tools; (4) clear commitment by the government to promotion and attraction of investment; and (5) more aggressive investment promotion activities.

5.2.4 BKPM's Criteria for Selection of Priority Sectors for Investment Promotion

The government has established the investment promotion strategy that is centered on the effective response to investors' request. To implement the strategy effectively, BKPM is expected to focus on the following six activities.

1. Intermediary service for banks and non-bank finance institutions
2. Protection of specific business areas by using the negative list
3. Integrated promotion to pick up existing opportunities through various events
4. Promotion of simplified or adequate technologies developed by local R&D organizations
5. Dissemination of information opportunities and related information via the media
6. Implementation of investment promotion activities for all regions (local governments) to encourage smooth flow of capital throughout the country

As pointed out, however, BKPM does not perform adequate analysis of investment trends to prevent effective promotion for potential investors. BKPM currently selects countries and industry sectors for investment promotion from those that ranked high in the previous investment data, by extrapolating the past investment trend.

Although extrapolation is a conventional method for trend analysis, reliance on the method alone creates a risk of overlooking a meaningful change in investment composition or structure.

5.3 Recent Move toward FDI Expansion

Countries have been examining and implementing a variety of methods to promote foreign investment, including fiscal/non-fiscal incentives, development of infrastructure, industrial estates, and the export processing zone. As the investment climate varies greatly among countries, however, these methods are adapted to reflect local conditions in each country. In other words, there is no investment promotion policy or program that can be applied to any country. Meanwhile, it is noteworthy that the SEZ approach is receiving much attention in Indonesia because of its great success in South and East China.

The recent notable move in Indonesia is the formulation of the National Special Economic Zone Development Team pursuant to Coordinating Minister Decision No.Kep-21/M.EKON/03/2006 dated March 24, 2006. The team consists of a director team and an implementation team and is responsible for the following activities.

1. Evaluation and formulation of national policy and strategy relating to SEZ development
2. Implementation of research and study on an area that can be developed as a SEZ by using various parameters
3. Implementation of research and study on the needs for infrastructure, incentive, and other

measures required to develop the SEZ by using various parameters

4. Support for the establishment of a regional development and management team in the area where the SEZ will be developed
5. Evaluation and monitoring of implementation of a SEZ development project and the development and proposal of required policies and programs
6. Evaluation and formulation of regional development policies and strategies on the basis of the National Regional Spatial Development Plan

As a realistic approach to implement the SEZ in the country, transformation of the Batam Bonded Processing Zone to the SEZ is being considered. In addition to Batam, other areas facing the Singapore economic zone - including Bintan and Karimun – will likely be developed as model SEZs in Indonesia, on the strength of their long-term experience in managing the EPAs and Singapore's strong commitment to development support and expansion of investment.

5.3.1 Major Issues Relating to Indonesia's Investment Climate and Expectation for SEZ

Prior to the establishment of the SEZ, extensive discussion should be made with regard to legal procedures, regulations relating to operations of companies within the SEZ, a relevant taxation system, customs duties, labor management regulations, and the establishment of infrastructure development costs. Questions to be addressed here include: What economic impact will the SEZ will have on the country? How different is the SEZ from the EQZ? What is the rationale for the SEZ? Generally, the industrial estate is developed with an aim to attract companies efficiently and promote industrial development, whereas the EDZ is designed to promote effective economic development, while having the functions of the industrial estate. The latter includes an economic zone, a bonded area, and an export processing zone. The industrial estates and the special economic zones offer various incentives to attract foreign investment, which vary according to the type or ownership of company. For instance, exemption of income tax for two years and 50% reduction for the ensuing three years are generally granted in China.

In Indonesia, incentives covering the KAPET (special economic development zone) and other special economic zones, as well as pioneer industries, are provided. However, they are designed to promote development of rural regions including the east, and they are rarely used because investment in these regions is not attractive for most companies. Thus, this investment promotion policy emphasizes regional development and does not represent an aggressive economic development strategy.

(1) Economic development and roles of industrial estates

Development of the investment climate should ideally be carried out on a national scale,

but it is rather difficult due to budgetary and institutional constraints. At the same time, as development of the good investment climate is essential in attracting investment project smoothly, an alternative approach is to do it in a selected area by diverting resources and efforts.

This approach was initiated in Taiwan and has been adopted in other Asian countries. Taiwan has already discontinued the strategy. Recently, Thailand, China, and Vietnam have successfully attracted foreign direct investment by using the approach. At present, as China boasts geographical concentrations of production facilities in a variety of industries and is dubbed the world factory, other Asian countries aim to become the second largest production base next to China and thus avoid direct competition. And Vietnam is now emerging to establish its position. In the country, there are approximately 100 industrial estates that accommodate foreign and local companies. Most of them have selected the country to use its low-cost, abundant labor force. According to data published by the Ministry of Investment and Planning in 2002, more than 90% of companies operating in the country's industrial estates are manufacturing establishments.

Foreign companies operating in Vietnam are ranked by their nationality as follows. Japan accounts for the highest share, followed by Taiwan, South Korea, Malaysia, the Netherlands, the U.S., Singapore, Thailand, Australia, and Hong Kong. In fact, these countries are known to invest heavily in other Asian countries. However, this does not necessarily mean that all industrial estates are operated well. In Vietnam, industrial estates with high occupation rates are mainly found in Hanoi and Ho Chi Ming, while those in other regions or cities face difficulty in finding tenant companies. In Japan, industrial estates are mainly viewed as a source of economic benefit to local communities, while discussion or consideration to make them attractive to investors is rarely made. As a result, many local governments create budget deficits by developing industrial estates that do not offer locational or other advantages to potential investors.

(2) Rationale for development of industrial estates and the need for sharing responsibility

Industrial estates are generally developed by the host country as part of its effort to improve the investment climate. In Asian countries, however, the task is often assigned to private developers who have experience in development and management of industrial estates. This means that the industrial estate is developed as a commercial investment project. At the same time, the government should be responsible for construction of access roads, supply of utilities, and installation of communication facilities. Thus, the proper sharing of responsibility by the government and private sectors is the first step and prerequisite to successful development of industrial estates.

(3) Key success factors for industrial estate development

1) Factors for alluring investors

The most important factor to be considered in development of industrial estates is their location, followed by availability of infrastructure serving them - not to mention the existence of policy and policy instruments to promote investment.

The location in this sense implies the following conditions that make an industrial estate suitable for investment: (1) availability of competent labor force; (2) stable supply of utilities; (3) accessibility to the market and raw material sources; (4) industrial estate operation and management capabilities; and (5) the adequate living environment for expatriate workers. In addition to these conditions, the proximity to a stable supply source for low-cost and high quality materials (i.e., raw material-oriented location) makes the perfect location.

Note that the industrial estate operation and management capabilities vary greatly among developers, but they determine the entire quality or reputation of an industrial estate in some cases.

2) Other factors

Another key success factor is effective promotional activity. This is also true for the improvement of the business environment. Making the development of an industrial estate or the improvement of the business environment known to potential investors is the starting point for investment promotion.

5.3.2 Development of Industrial Estates for Economic Development

The special economic zone features availability of public support, infrastructure, utilities, and other services that ensure efficient business activities, as well as various incentives for companies operating there. It can therefore be defined as the area where the favorable investment climate is provided to support efficient business activities. This means that special economic zone is not necessarily specialized in support of export companies.

Under this broad definition, the SEZ can contain an ordinary industrial estate, an export processing zone, a bonded area, a specialized industrial estate, where tenant companies can enjoy various incentives attached thereto. As the size of the SEZ increases, industry's dynamism expands and collaboration between companies emerges, resulting in a higher economic efficiency and economies of scale. At present, the development of the SEZ is often discussed from the viewpoint of merely building a system to support business activities by maximizing economic efficiency in the area. However, for a real success of the SEZ, the development of effective support systems and institutions is required in both fiscal and

non-fiscal aspects, such as the buildup of industry's dynamism to enable investing companies to expand activities permanently and the development of a system to supply competent workers. The Shenzhen SEZ in China is said to be a primary example of pursuing this goal and is characterized by investment promotion activities and the development of the investment climate to promote continuous expansion of industrial amalgamation. In particular, the SEZ promotes transformation of general industrial estates to specialized ones as well as the effective linkage between them in order to create new business opportunities by encouraging synergetic alliances between companies in different industries/fields, while allowing efficient procurement and supply of parts and components. At the same time, it evolves by extending incentives to the installation of private R&D organizations and their collaboration with universities and public research institutes.

5.4 Action Plan for Policy Recommendation

(Rationale)

In order to prepare a recommendation for investment climate improvement in Indonesia, the Study Team sets a project vision as “stubborn and realistic”. Accordingly, all of draft action plans and strategies for investment climate improvement are evaluated in these criteria.

In addition and as discussed, investment climate is categorized into three aspects (Comprehensive, Starting business, Doing Business).

Strengthening of investment promotion activity and consolidation of legislative background (at Comprehensive level)

The first aspect concerns the overall investment policy. In order to accelerate FDI into the Republic, setting-up of IPS (investment priority sub-sector) should be firstly discussed among line ministries and other key ministries such as BAPPENAS and Coordinating Ministry of Economy. After the separation of MOIT into Ministry of Industry and Ministry of Trade, priority sub-sector to be promoted was enumerated separately and made the list all-round type. Moreover, it made difficult to give any incentive to the prioritized sub-sectors.

- Setting-up of deliberative committee for investment priority
- Reinforcement of function of BKPM in terms of promotion activity
- Strengthening of promotional tools

Development of integrated services system (at Starting business level)

After the announcement of comparison data for investment-procedure-duration by the World Bank, it became the symbol of opaque and inefficient public services of Indonesia. To minimize the duration fully correspond with the request from the government now.

- Integrated service

Improvement of business performance conditions (at Doing business level)

This is the most serious category for business sector than two other categories. Investors shift their operational basement or start their business at the country where business performance consider advantageous. Also, improvement of business climate is the most concernment issue for existing investors in the republic.

- Improvement of business performance conditions

5.4.1 Development Strategies and Projects

The Study Team has set the following development strategies based on the understandings derived from the study result under the above logic. The study result means “facts which is relating to investment climate”, “comparative advantages”, “ideas given by field survey at four Asian countries: China, Thailand, Vietnam and Philippines”, “hearings from advisory members and stakeholders” and evaluation result within the Study Team.

Selected development strategies	
◆	Strengthening of investment promotion activity and consolidation of legislative background
◆	Development of integrated services system (at Starting business level)
◆	Improvement of business performance conditions (at Doing business level)

Projects under each strategy	
➡	Setting-up of deliberative committee for investment priority
➡	Reinforcement of function of BKPM in terms of promotion activity
•	Integrated service
•	Strengthening of promotional tools
•	Improvement of business performance conditions

5.4.2 Preparation of Long List: Logics to Prepare Policy Recommendation

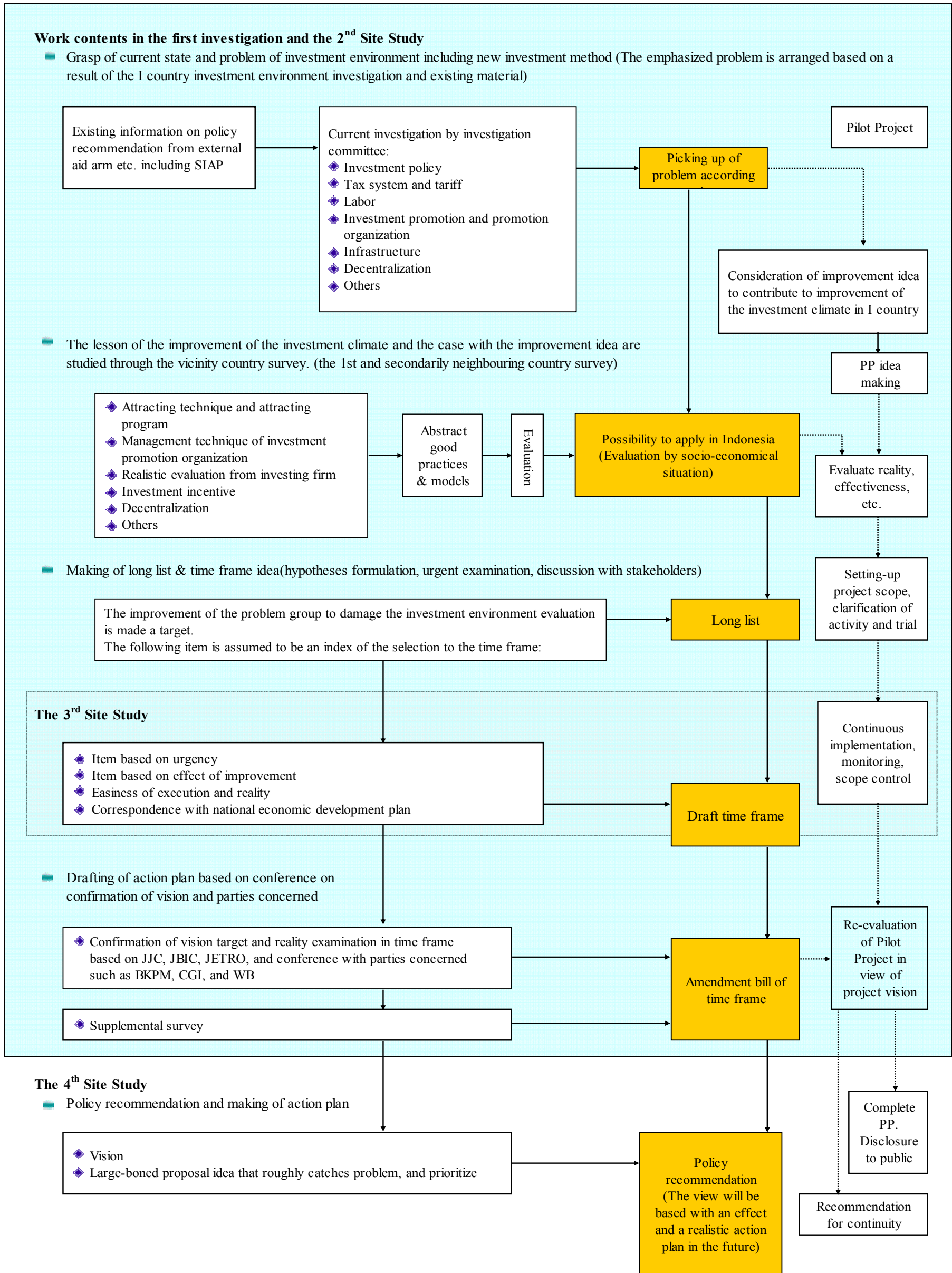
- (1) Pre-condition to remunerate from fact finding survey in the Republic

Logic flow to obtain long list is illustrated in Figure 5-11.

Figure 5-11 Flow of Time Frame Making of Indonesia Investment Policy Improvement Study

Policy of time frame making in field investigation

The first time frame idea is made based on the result of the 1st field survey. Drafting of time frame and long list is as follows.



The precondition when enumerating a long list was set as follows.

The theme to which the improvement proposal to be made in the enumeration of investment climate targets "investment policy". Investment climates are categorized into three as: 1* the one that BKPM was able to implement even at once, 2* the one of which needs deep deliberation within the government, 3* the one the government was not able to control. Therefore, themes in the enumeration are included in the first two categories. It is treated as a case with "3*" when the case is executed based on specific socio-economic background in which Indonesia can not lay down even if there was a case that becomes good lesson.

"The one that BKPM can start it even at once" includes the review of a basic policy, the law system, and the limitations related to the investment and the investment promotion activities¹, etc. and, " the one of which needs deep deliberation within the government" includes the labor regulations and the foreigner work permit regulation, etc. Themes relating to labor law and customs clearance procedure needs adjustment within Ministry of Labor and Transmigration and Ministry of Finance.

1) Target investment climate for investment policy improvement

Among such invest climates in Indonesia as sociopolitical factor; target investment climate for the policy improvement is classified. Sociopolitical factor includes political situation, natural condition and social condition. As for natural condition and social condition, it includes geographic location, climates, whether, water resources, mineral resources and public security, education and medical care respectively.

The political climate, natural environment, and the social climate, etc. are included in politics and a social factor. As for natural environment and the social climate, a geographic position, the climate, the weather, the water resource, the mineral product, the public peace, the education, and the medical treatment are included respectively. These all become off the subject of the main enumeration.

2) Consistent with SIAP and the Policy Package for improving investment climate

SIAP (The Japan-Indonesia Strategic Investment Action Plan) was prepared by the High Level Public/Private Sector Joint Forum on Investment launched on December 16th, 2004, in Jakarta, following two leaders' agreement on the principle of its establishment in November 2004 in Santiago, Chile.

The two leaders, prime minister J.KOIZUMI and the president S.B. YUDHOYONO,

¹ In BKPM, because it is not a policy making agent, the adjustment with Ministry of Trade is needed.

acknowledging the Indonesian objective of doubling the volume of foreign investment to Indonesia from each investing country, including that from Japan, over the next five years, decided to cooperate under the SIAP to achieve its objective by improving investment climate in Indonesia with the President's strong leadership. Based on this political background, SIAP was announced jointly on June 2nd, 2005 as a new bilateral initiative to promote foreign direct investment, especially from Japan.

The SIAP is composed of concrete actions, the list of which is attached. These actions are subdivided into the following four areas: tax/customs, labor, infrastructure and industrial competitiveness/small and medium-sized enterprises.

a) Tariff and customs clearance

- i) Introduction of self-return system in tax levying
- ii) Improvement of VAT system to promote exportation
- iii) Protection of rights of tax payers
- iv) Strengthening of transparency in tax levying
- v) Improvement of tax levy system to ensure business cost reduction
- vi) Improvement of tax levy system to promote manpower exchange with foreign nations
- vii) Continuation of dialogue between the government and business sector
- viii) Elimination of political barrier to ensure smooth customs clearance
- ix) Encourage professional ethics in customs clearance procedure
- x) Publicize interpretation of regulations on a new customs clearance
- xi) Introduction of EDI system and a Custom office' official website
- xii) Expansion of function of bonded warehouse
- xiii) Fostering transparency and purity in customs clearance procedure
- xiv) Solving remaining difficulties relating to customs clearance

b) Manpower

- i) Review manpower relating regulations to accelerate competitiveness of private businesses
- ii) Execution of industrial dispute conciliation law to realize speedy and fair settlement
- iii) Introduction of social system such as vocational training, employment agency and national licensing system to ensure fair, appropriate and high labor productivity
- iv) Simplification of business visa obtaining procedure to make business activities of foreigners smooth

- v) Establishment of practical social security system
- c) Infrastructure
- i) Promotion of new regulation and plans to accelerate private participation into infrastructure project
 - ii) Preparation of practical national plan for infrastructure development
 - iii) Implementation of close dialogue between private investors and the government for infrastructure development
 - iv) Improvement of important infrastructures to promote investment
- d) Industrial competitiveness and SMEs development
- i) Preparation of industrial strategy to strengthen competitiveness of the country
 - ii) Promotion of supporting industry
 - iii) Strengthening of services of BKPM to investors
 - iv) Protection of intellectual property in the domestic market
 - v) Introduction of international industrial standards
 - vi) Promotion of national acknowledgement for EPA (Economic Partnership Accord)

Official assistance projects by JICA, JBIC, JETRO and private cooperation by Japanese business sector have already started.

- 3) Policy package introduced in March 2006 and a new investment policy under discussion as of May 2006.

Also, the government announced a policy package in 2nd of May to improve invest climate in the Republic. The package stipulates 85 action plans and their due date and responsible persons in 5 categories as a. General Policy, b. Custom Duty, c. Tax System, d .Manpower, e. SMEs and Cooperative. A new investment policy, however, stipulates only basic principles of investment relating categories. Only a few items and sentences gave significant information to be studied. Especially in the responsible body of investment licensing become again unclear by the policy.

- 4) Fact finding study to identify constraints of investment climate

As identified and discussed in the Chapter-2, there are various constraints caused by various reasons such as socio-economic background, financial shortage, external climates and others. Up to now, various problems have been pointed out by a foreign aid agency and the investor, etc. New labor act is not well accepted by domestic workers because the act is likely

to be received as abortion of vested right in the history. The Study Team has reviewed the investment policy (legislation, law, infrastructure, and tax system, etc.) in Indonesia as a prior preparation based on existing material and the report. The investment climates that were not able to be identified enough by a domestic prior investigation in the field investigation or the presence of the change afterwards and the content of the change were caught, investigated, and the background and the realities of the problem that Indonesia investment climate had were clarified. Especially, the current state was investigated without limiting to the system side like the style and the processing method of a reason and various documents behind which various procedures besides the customs work were delayed etc. and noting the problem on the operation side.

5) Lessons learnt from investment comparative survey

(Political measures changes based on the socio-economic condition of each country)

During the 1st and 2nd comparative survey, the study team visited four countries: Thailand, Viet Nam, China and Philippines.

In Thailand, investment procedures and promotion activities are focused mainly in BOI based on the centralization policy. Therefore, investment relating services are intensively provided and authorized by BOI. Such system is preferably welcomed by investors.

In China, the central government stipulates only the basic investment rules. In Viet Nam, investment rules are regulated by the central government and public agencies operate the rules. In 1978, China started open market policy by developing four special economic zones at southern coastal area and has been continued their challenge to apply market economy. In corresponding to the open economic policy, the government of China strengthens the decentralization policy to urge competition among municipalities. Investment promotion method, public services for licensing procedures, fiscal incentives differs province to province and city to city, therefore. More precisely, if one municipal government has abundant budget or expected high viability of investment project, they can propose additional fiscal incentives within the framework of basic regulation constituted by the central government. In addition, municipal government is able to set own investment priority plan to invite promising industry to the area.

In Philippines, investment priority plan which announces every year shows definite wishes of the government. The reason why their investment priority becomes definite is due to poor natural resources in the country. Not like Indonesia, Philippine is poor in natural resources. Therefore, added value trading is a strong concern to the government to boost economy. On the contrary, investment priority of Indonesia become all round type because Indonesia has a big potentiality to develop almost all industrial sectors in terms of rich natural resources.

The Table 5-2 indicates a long list for action plans.

Table 5-2 Long List (long list for proposed action plans)

Project		Action Plan	
1	1	Simplify investment procedure	
	1	Simplify investment application form	Prep. of Manual, Eliminate flowchart
	2	Minimize investment approval period	From 10days to 5days. Simplify internal settlement procedure
	3	Go online of investment approval procedures	Online access of investors
	4	Minimizing duration to get permanent operation license	Minimize 14days to 7days. Simplify internal settlement procedure
	5	Minimize TDP issuing period	Minimize 10days to 4days. Simplify internal settlement Revise handling procedure
	6	Minimize issueing priod of SK hard copy	Minimize from 2-3 weeks to one week. Revise paper works fundamentally
	7	Prompt announcement of newly registered company through official gazette	Minimize present 2-3 months to one month by computerization
	2	Strengthening of customer service	
	1	Introduction of tracing system of investement licensing procedures	Implementation of the main milestone check by online system introduction
	2	Establishment of call-center	Customer service by introducing tracing system
	3	Liberalization of investor selection of licensing office	Introduction of front office service of investment application and preparation of master list at state capital based on
	4	Investment achievement improvement by investment results figuring-out	Comparison analysis between application and results of invesment
	3	Developing new services of BKPM(Re-allocation of human resources)	
	1	Strengthening of customer service	Strengthening of investment engineering function Strengthening of investigation function: i.e., deviation analysis between investment applying and achievement, withdrawal and Fostering of investigation capability (including application and results of investigation) Strengthening of investment consulting function Implementing capacity building to local governors according to decentralization
	2	Strengthening of promotion agent	Industrial cooperation conclusion among major countries
	3	Strengtheining of planning function	Company wide project division based project planing function: establishment of investigation section
	4	Planing of investment promotion strategy	World wide production trend, industrial linkage, comparative
	5	Improvement of organization structure	Clarification of operational domain and principles of BKPM Reexamination in the administration of BKPM Reorganization turned to functional enhancement as investment promotion organization Fostering of investigation function: statistic data compilation/reinforcement of library
	2	Investment law (shifts to a transparent system that clarifies policy and direction)	
	1	Recommend to listing up of prioritized subjects	
	2	Contents that hit detailed rule	
	1	Negative list	Making of negative list making public (The one not made public by reflecting is included)
2	Investment procedures	Introducing most highest tracavility system than competing countries and establishment of Call-center function	

Project		Action Plan
3	Negative list (shift to a transparent system that clarifies policy and direction)	
1	Disclosure of list timely to ensure transparency	
1	Disclose all the list including internal guideline	Disclose the list in the form of the investment guidance(It explains the point of the interpretation) Preparation of detailed instruction manual and Q and A
2	Quick disclosure of negative list when	
4	Labor law (Development of labor-management harmonization relation)	
1	Deliver an information that can support revision of labor law	
1	Severance pay	Revise outrageous severance payment in comparison with Thailand and Viet-Nam
2	Employment system (Outsourcing, fixed-term employment contract)	Recommend more preferable employment system
3	Short period working visa	Abolish short term working visa
2	Recommendation to develop a management-labor friendship system	
1	Shift to cooperation relation from confliction	Develop WIN-WIN relationship (Assure a reward to strength competitiveness)
3	Compiling of law report on labor disputes	Convention and law report to be compiled at labor-management dispute adjustment scheme in January 2006.
4	Try hard to keep both labor and management about labor dispute law	capacity building to both labor and management of SMEs.
5	Restructuring and improvement of infrastructures (PPP: Public-Private Partnership)	
1	Promotion of PPP	
1	Power supply business	Propose a minimal governmental assisting method in view of business character Propose new PPP scheme including structure and financing
2	Toll road and highway business	Propose a minimal governmental assisting method in view of business character Propose new PPP scheme including structure and financing • Super long revenue bond (Tax exempt, Zero coupon bond)
3	Water supply business	Propose a minimal governmental assisting method in view of business character Propose new PPP scheme including structure and financing • Nepotistic (private subscription) bond, local bond
2	Revision of investment policy to promote PPP	
1	Getting into the new investment policy	Add BOT, BOO and BTO as a new investment concept
2	Establishment of infrastructure development bank	Collect local currency by bond flotation and then invest in infrastructure development (float as government guarantee bond)
3	Strengthening of BKPM	
1	Re-organize organization and reinforce operation system	Enforcement of staff (strengthening of counter service staff) Increase of staff (strengthening of office center work)
2	Practical business operation	Strengthening of investigation and engineering function Enforcement of investment promotion activity (Attract foreign investor abroad and establishment of investment advisor)
3	Strengthening of one roof function	Licensing & approval service by BKPM instead of local government (at Jakarta) Give freedom of arbitrary selection to investors when start investment procedure
4	Improving services to investors	Deliver of investment procedure manual and licensing samples Disclose investment success story, information on industrial parks through website
5	Making investment rule book (in English)	Disclosure of investment relating laws and regulations through

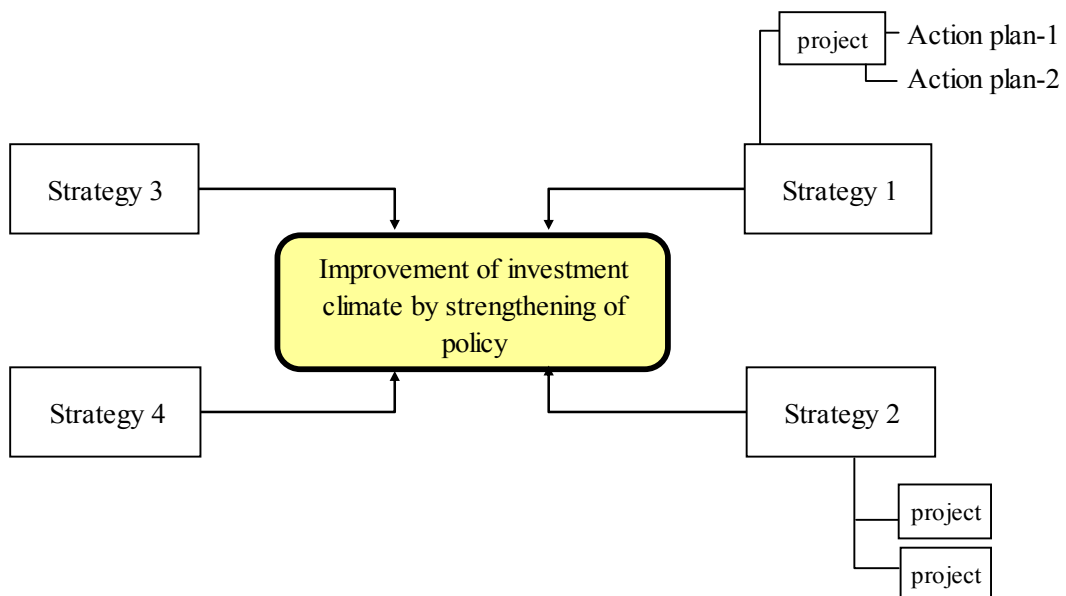
Project		Action Plan
6	Introduction of aggressive investment incentives	
	1 Development of investment attracting tools	
	1 Model industrial park plan Intensive fostering of industrial parks' 3 major factors (infrastructure, labor force supply, incentives)	Intensive and priority development of infrastructure One stop public services : Cover export promotion to direct investment procedures Development of one stop service for foreign business Intensive service of customs clearance and bonding operation within a park. Computerize(EDI) customs information. Introduce and promote industrial parks through BKPM website Develop Supporting SMEs specialized industrial parks having common service facilities like effluent water treatment,etc.
	2 Special economic zone plan	Nominate national promising sectors Nominate Execution of investment priorities plan : public-private joint effort to develop industrial parks as investment tool
	2 Introduction of tax reduction or incentives depending on sector and scale of employees	
	1 Incentive sector	Categorize government incentive sectors by hierarchical ranking then decide scale of tax reduction or exemption
	2 Scale of employees	Decide scale of tax reduction scale by scale of new employment of citizens
7	1 Investment of tax practice	
	1 Promotion of computerization	Promotion of streamlining by computerizing and elimination of unreasonable payment
	2 Improvement of VAT refund method	Minimizing proceeding period and conclusive refund by simplifying of the system
	3 International standardization of advance payment system	International standardization of the current system to simplifying procedure and elimination of over paying

5.4.3 Making Short List Process

Firstly, the Study Team sets up criteria to select priority action plans to be tackled in the project. Criteria are shown here.

- 1 Whether the action plan can suggest any practical measures on proposed themes in SIAP
- 2 Whether the action plan can get consensus from counterpart, BKPM advisor, advisory members and stakeholders
- 3 Whether the action plan proposed by the Study team are fully based on the fact
- 4 Whether the action plan can correspond significantly with the project objective (refer to the following structure)

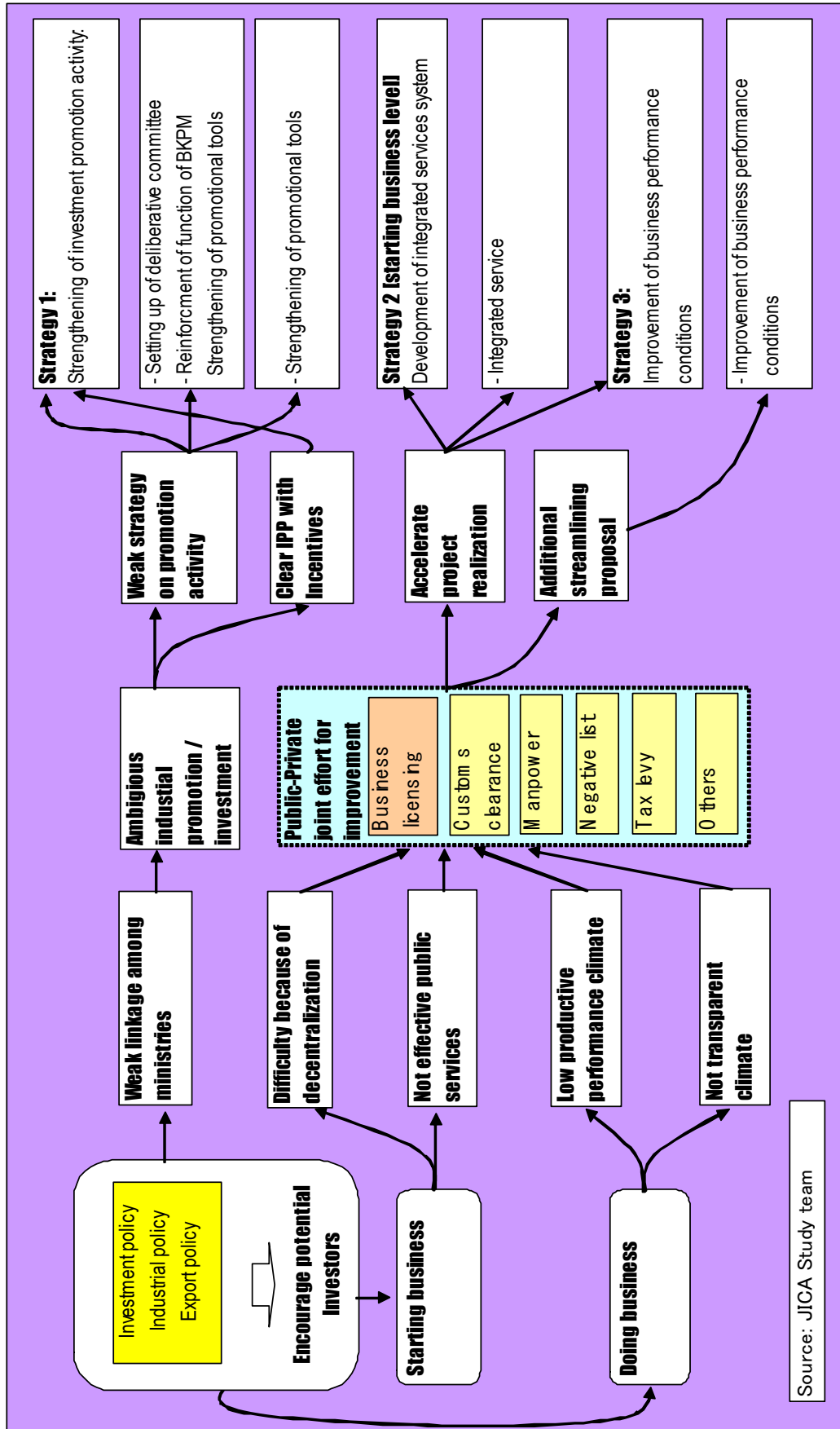
Figure 5-12 Structure: Project target and Action Plans



Source: JICA Study Team

The following process explains how the Team enumerated priority action plans: short list.

Figure 5-13 Making Short List Process



Source: JICA Study team

5.5 Recommendations and Proposed Action Plans

5.5.1 Strengthening of Investment Promotion Activity and Consolidation of Legislative Background at Comprehensive Level

5.5.1.1 Setting-up of Deliberative Committee for Investment Priority

(1) Rationale

Everybody agree with the difficulty in enforcing joint legislation among different ministries. However, making a unified priority plan is the fundamental start point for investment promotion activity. In Indonesia, there is a practical model for joint activity in prioritizing infrastructure project. If we can do likewise, investment priority subsector maybe clearly identified with definite incentives. Clear investment priority plan can be established by cross-sectoral standpoint among relating ministries.

(2) Purpose

As discussed in the Chapter 5.2.2 and 5.2.3, association of a taskforce team or a deliberative committee for investment priority discussion will be the fundamental point of starting. With the clear investment priority plan, definite promotional strategy and tools can be prepared. On the contrarily, BKPM will not able to implement effective promotion activity without any definite priority plan. In addition, fiscal and non-fiscal incentives will be a good promotional tool to encourage potential investors and will be a good measure to extend Indonesia's big wishes to welcome investors.

(3) Output of the Project

Association and taskforce team to determine clear IPP.

(4) Project description

Ministry of Industry prepares an industrial promotion priority sub-sector list in view of national needs and of economic efficiency. Similarly, Ministry of Trade prepares a prioritized business field. BKPM prepares a proposed investment priority sub-sector based on the annual activities specializing in investment promotion and permission procedures. Coordinating Ministry of Economy and BAPPENAS take part in the committee meeting as a facilitator to wrap-up the discussion.

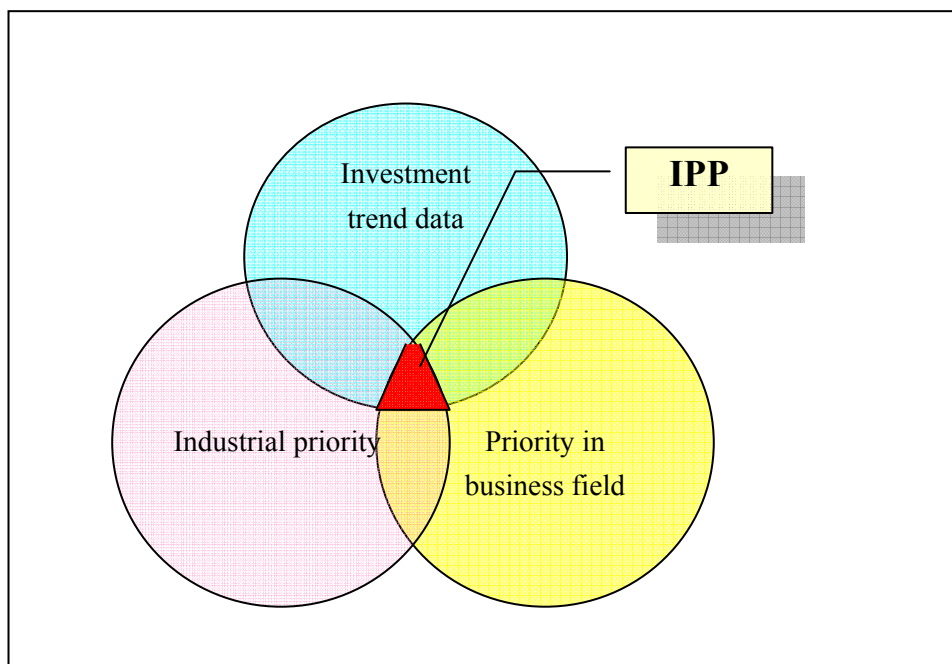
The structure of the association is proposed as follows.

- Executive board member (Line ministries): Ministry of Industry, Ministry of Trade and

- BKPM
- Board member (associate member): Ministry of Information and Telecommunication, Ministry of Forestry, Ministry of Agriculture, Ministry of Culture and Tourism and Ministry of Finance
 - Evaluation and facilitation member: BAPPENAS, Coordinating Ministry of Economy

Task force team associated with representatives from above organizations discusses investment priority plan in view of national benefit.

Figure 5-14 Investment Priority Area



Source: JICA Study Team

(5) Activities

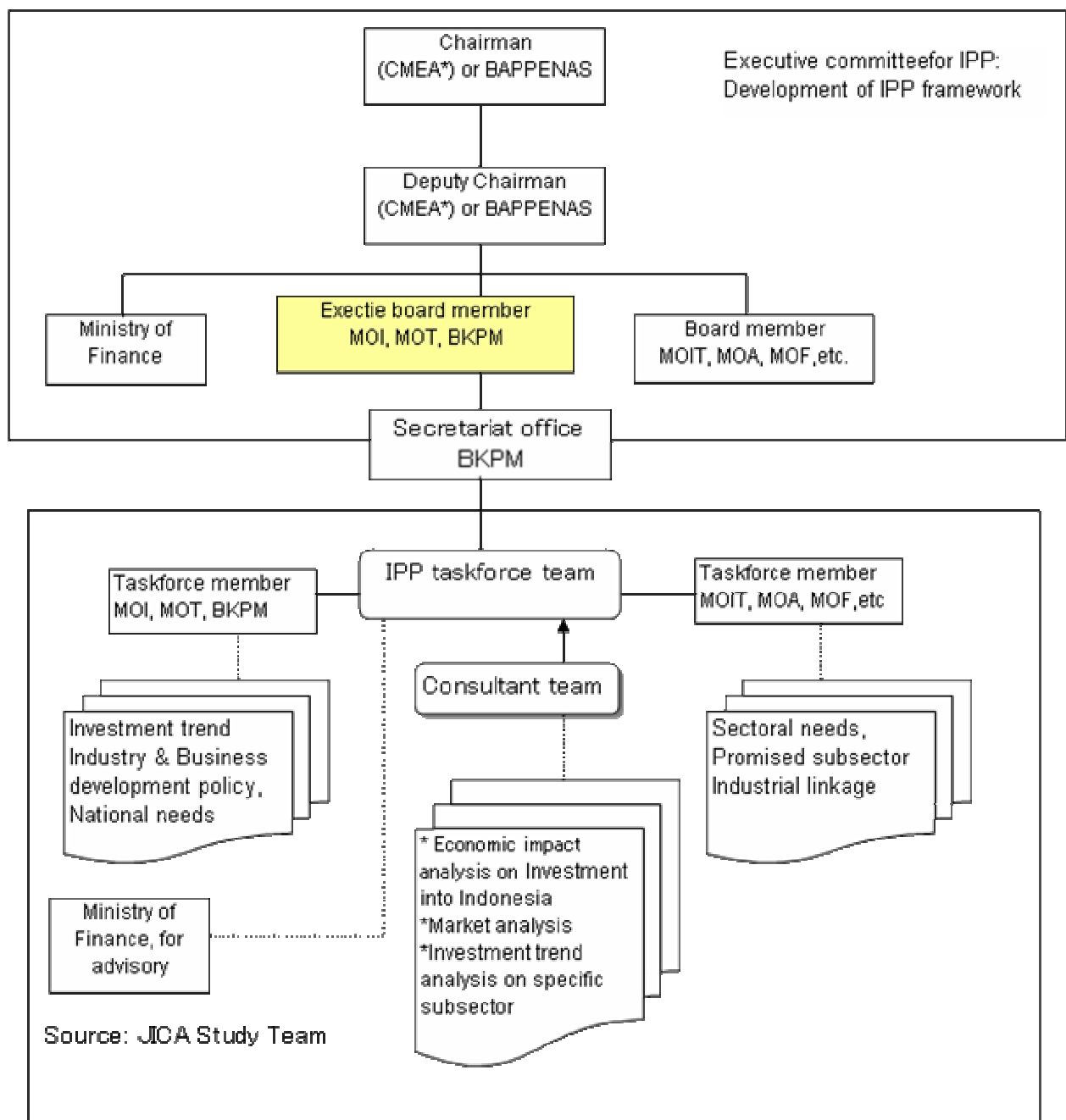
Each line ministry prepares own priority subsector based on each criteria and national needs. As shown in the Figure 5-14, IPP is categorized as the common area of each priority and considered as the highly prioritized sub-sectors complying with the national needs. More precisely, the major criteria to evaluate investment priority subsector is requested to cover a) national benefit, b) national needs, c) reality in terms of world investment trend, e) national needs in terms of projected development plan and f) efficiency. Therefore, taskforce team is requested to identify the subsectors which are mutually important among ministries. Facilitator from BAPPENAS and Coordinating Ministry of Economics wrap-up the evaluation result for setting-up IPP.

Investment priority subsector could be the industrial priority subsector and the priority

business field as well. This necessarily means that the investment priority subsector is the subsector which is one of the most important in view of national benefit. Accordingly, investment priority subsector can be the candidate for fiscal incentives when invest in Indonesia.

Operational and evaluation method of KKPPI (The National Committee on Policy and Acceleration of Infrastructure Development) can be applied to the IPP settlement.

Figure 5-15 Proposed Organization for Instituting IPP



(6) Time schedule

Proposed time schedule to establish the association is shown below.

Table 5-3 Time Schedule to Establish IPP Committee

	1 st quarter	2 nd quarter	3 rd quarter	4 th quarter	5 th quarter	
Reinforcement of BKPM in terms of promotion	-----					
Reorganize data analysis section	—————					
Promotion strategy development section establishment	—————					
Appoint taskforce team		—————				
Associate executive committee at ministries except BKPM		—————				
Enact presidential decree		-----			▲	
The first board meeting				—————		
Drafting of IPP					▲	

Source: JICA Study Team

5.5.1.2 Reinforcement of Function of BKPM in Terms of Promotion Activity

(1) Strengthening promotion function

1) Rationale:

It is necessary for the promotion organization (both BKPM and BKPMMD) to strengthen the promotion function such as organizational, personnel and financial in order to carry out promotion activity effectively and efficiently.

2) Purpose:

Make the best of BKPM's function to encourage potential investors in more effectively.

3) Output of the Project:

More promotion orient organization

Staff who has business mind

Budget enough to implement integrated promotion

Collaboration network with foreign investment concerned agents

4) Project description

In order to strengthen the promotion function, the following matters are examined and implemented

- Organizational structure
- Capacity building
- Collaboration of foreign organization

5) Implementation Body and financing source

BKPM and BKPMMD

6) Possible organization structure

BKPM and BKPMMD shall reform organizational structure to enhance promotion function including capacity building of promotion staff.

7) Activities:

Make organization reform and capacity building

Establish more closed relationship with foreign organization related to investment promotion.

8) Expected benefit of the project:

Necessary promotion function is well established to carry out promotion activity effectively and efficiently.

Closed relationship with foreign organization is well established.

Effective promotion tools and skills are prepared.

9) Weakness of the project

Organizational reform shall be necessary together with preparation of necessary manpower and financial background.

Attachment 1 shows the first year plan for the above Action Plan.

(2) Provide detailed and practical information in view of investor's needs

1) Rationale:

It is necessary for both BKPM and BKPMD to strengthen information services in terms of content and strictness. In this sense, "investment gateway" developed under the JICA Study is important to maintain in properly.

2) Purpose:

Provide investment relating information that can satisfy investor's needs.

Provide investor friendly services through well maintained website.

Provide practical and accurate investment relating information to appeal Indonesia's attitude for transparency.

3) Output of the Project:

More effective promotion tool is developed and delivered to the potential investor

4) Project description

a) Reportedly, the JICA Study team jointly with the BKPM working group developed a website which has a special objective to provide practical information for investment.

b) The website: Investment gateway, has three major portals for practical investment information

c) More detailed information about the project is introduced at Chapter 6 Pilot project.

5) Activities and Possible organization structure

It is necessary to establish a taskforce team within BKPM for operational purpose and maintenance purpose.

Operational taskforce team concerns the maintenance of the contents such as:

- ▶ Success Stories- Web Promotion Division
- ▶ Investment Procedure Manual
- ▶ Laws & Regulation- Laws and Regulation Div.

(Required capability or skills):

- ▶ No specific IT capability are needed, only need to have knowledge on the captioned content

(Other maintenance activities):

- ▶ Correct when mistakes found
- ▶ Update the obsolete content and maintain to keep the newest condition
- ▶ Announce the update/modify information to the users
- ▶ Record the update/modify history

System maintenance team will be responsible for the system security:

(What kind of tasks):

- ▶ Maintenance of Web-page
- ▶ Maintenance of Database

(Detailed maintenance works):

- ▶ Detect bugs and repair simple defects
- ▶ Maintain and observe the performance
- ▶ Periodical back-up of the System
- ▶ Review system manuals and consult with the system developer(Outsourcer)

Also, detailed explanation is given at the Chapter 6.

7) Expected benefit of the project:

Appropriate and sufficient information is provided to the potential investor in timely manner.

(3) Strengthen promotion activity by reinforcing BKPM's analyzing and research function

1) Rationale:

It is recommended for BKPM to reinforce a part of their section to strengthen promotion activity more effectively and efficiently.

BKPM is the leading actor for investment promotion in the republic. Moreover, BKPM is the sole public agent who can collect direct opinion from investors and has properties of years of services. However, these fruitful property accumulated by long efforts are almost neglected without touched.

This action plan proposes to put out more useful information on investment by strengthening analyzing and researching function of BKPM.

2) Purpose:

- To identify the investor's movement for effective promotion
- To identify definite investment trend world wide and to understand Indonesia's position to

- contribute effective development of (investment) promotion strategy
- To provide more practical promotion tools to encourage potential investors

3) Output of the Project:

Appropriate function for analyzing/researching of investment is established to approach target potential investors successfully

Close coordination with other ministries, organizations and commercial attache to overseas

Joint working scheme with embassies to strengthen investment promotion

Investors' movement shall be well captured for future promotion

World wide investment trend

Movement of investment and position of the republic

Realistic promotional tools

Business models that will encourage potential investors

Basic information on investment priority subsector

4) Project description

Establish an appropriate function for researching and analyzing

Conduct periodical business meeting and periodical survey (questionnaire) to identify their needs and to watch movement

Discover and introduce "Success Story" as good example of investment in this country

- Analysis of BKPM Original Statistic Data to Identify Investment Priority Area
- Strength Analysis Function to Identify the World Investment Trend, Position of RI and Investment Priority Area
- Introduction of Analysis Result to Other Ministries

5) Implementation Body and financing source

BKPM and BKPMMD

6) Possible organization structure

BKPM and BKPMMD media promotion

7) Activities:

Preparation of questionnaire to identify the following data:

- Needs from investors
- Comparative advantages of the republic in view of investors
- Comparative disadvantages in view of investors

- Position of Indonesia in terms of globalism of production
- Business performance condition in view of investors
- Investment priority subsector

Analysis and evaluation of data collected to identify the following aspects:

- Investment priority subsector
- Investment promotion strategy
- The most promised subsector in the future
- Priority country for promotion activity
- Economic effect or impact by FDI

Collection of data

- Investment trend information prepared by foreign chamber of commerce and international aid agents (the World Bank, JETRO, JBIC, IFC and etc.)
- Periodical report on investment by capable foreign agents (JETRO Sensor, Questionnaire survey report for investment, etc)
- Conducting interview survey at exhibition overseas and to Jakarta office of foreign agents
- Conduct periodical business meeting with influential investors
- Periodical exchange information with related ministries/organizations about movement of in-flow investment and potential investor.
- Carrying out joint promotion with the ministries by unifying contact point for targeting investor.
- Periodical information providing and opinion exchange with commercial attachés of overseas Indonesian embassy to share information about investment promotion.
- Tie-up of carrying out joint investment promotion with commercial attach to overseas Indonesian embassy when it is necessary.

Report making

- Questionnaire survey evaluation report
- Periodical survey report to summarize monthly activities
- Investment priority subsector
- World investment trend and position of Indonesia in globalizm

8) Expected benefit of the project:

Closed relationship with foreign investor will be established

Investors' movement shall be well captured for future promotion

Integrated promotion and information network with diplomatic establishment abroad.

5.5.1.3 Strengthening of Promotional Tools 1 (Promotion of infrastructure projects as business opportunities)

(1) Purpose

This Action Plan aims at developing framework conducive to implement effective promotion activities in the filed of private participation to infrastructure projects. The Action Plan includes a particular emphasis on enhancing BKPM's capacity and role in the promotion activities by establishing close relations and coordination with other key authorities.

The reason to target BKPM's role is that there is no organization other than BKPM, who is capable of executing promotion activities effectively. In Indonesia, the promotion activities are carried out by each line ministry, respective sections such as DINAS or BAPEDA of local governments, or state-owned companies such as PLN. All information related to infrastructure projects are disseminated or published so less integrated manner that potential investors have to contact the institutes concerned one by one to obtain information such as completed projects, on-going projects, as well as prospective projects. The Development Unit for Communications in KKPI is supposed to manage cross-sectional promotion activities related to infrastructure projects. The Unit organized Infrastructure Summit in 2005 and will held Infrastructure Conference in 2006 as well as publishes a monthly magazine. Due to a lack of the capacity, however, it can implement neither the regular promotion activities such as consulting/advisory services nor the promotion activities in abroad. The disadvantages of the promotion activities by those organizations are listed as follows:

- Ad hoc base promotion only.
- No permanent promotion activities.
- No agency to handle inquiries from investors as daily activities.

Those weaknesses are attributed to:

- Not specialized agencies to carry out promotion
- Limited knowledge and network to conduct effective promotion
- Limited budget and capacity, especially KKPI.

The crucial point to materialize this Action Plan is to enhance business sense of BKPM and its capacity and knowledge on investment to infrastructure projects. BKPM has taken infrastructure projects as investment climate, and thereby it has not dealt with the PPP infrastructure projects. Amid the government efforts to lure private investment to infrastructure projects, BKPM should change its view on infrastructures and to add necessary capacities to manage the promotion activities.

(2) Project Description

The Action Plan is composed of six programs:

- Establishment of a section in charge of the promotion activities of infrastructure projects.
- Building of base knowledge.
- Construction of cooperative relations between the unit and KKPPI
- Organization of informal meeting with private sector
- Collection of information related to infrastructure projects

The figure shows the figurative explanation of the Action Plan.

1) Establishment of a section in charge of the promotion activities of infrastructure projects.

The objective of this program is to establish a unit which takes charge of collecting information and data related infrastructure projects and executing promotion activities. It is not necessary to mean that BKPM should establish a new unit. This program especially emphasis on the role of the Directorate of Infrastructure Development Resources. The directorate is responsible for collecting and analyzing information related to infrastructure, although has not handled information on private investment infrastructure projects.

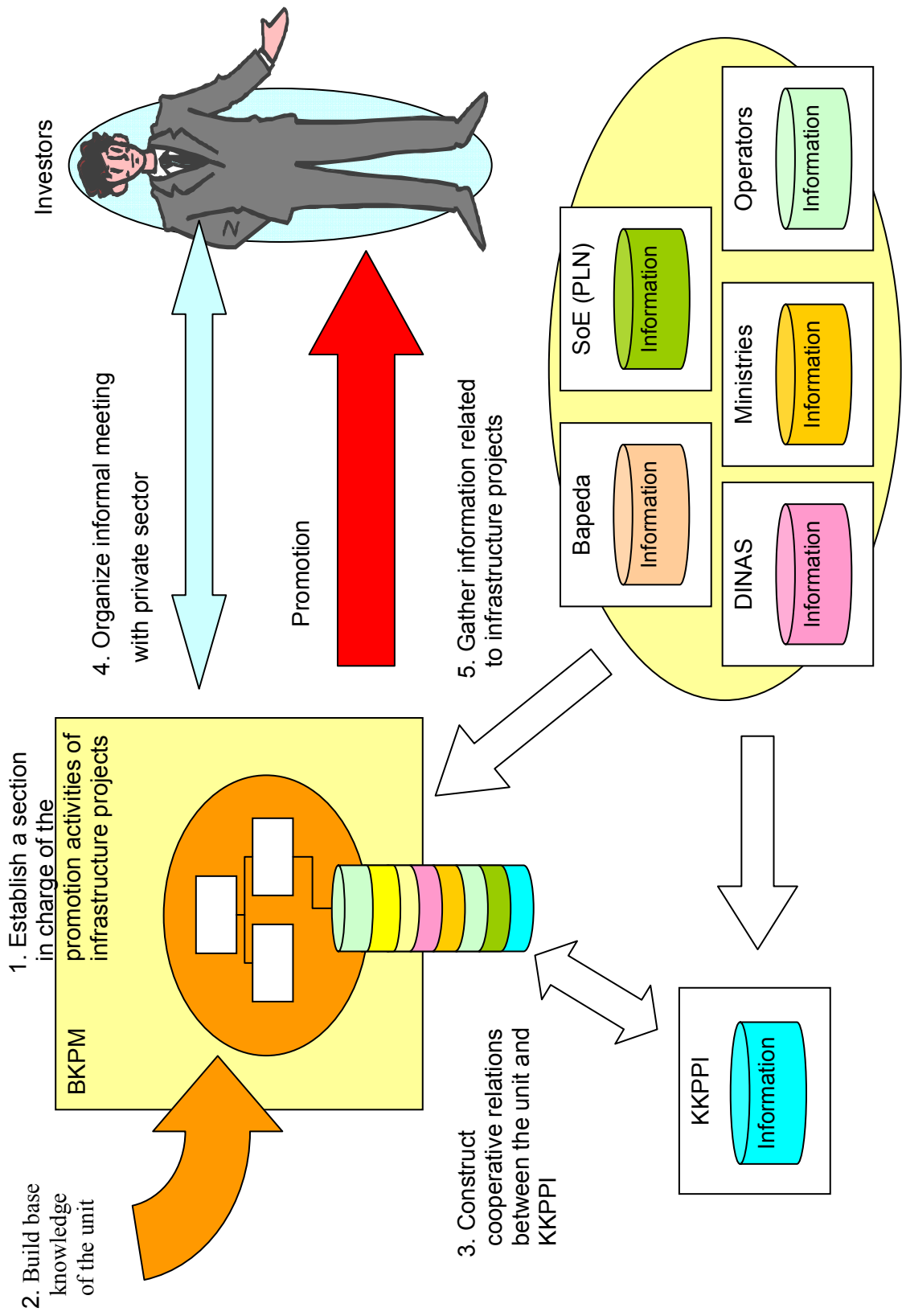
This program should be implemented by the following steps:

- a) Enhancement of the portfolio so as to enable the directorate to cover information related PPP projects as well.
- b) Establishment of a cross-sectional unit composed of representatives from the Directorate of Infrastructure Development Resources and Directorate of Promotion.
- c) Building of base knowledge of the directorate and the unit (refer to 2.2).

2) Building of base knowledge of the unit

The objective of this program is to strengthen capacities of the Directorate of Infrastructure Development Resources and the unit through human-resources development and training. Because the concept of private investment into infrastructure projects or PPP (Public Private Partnership) is complicated, they may not be able to execute its activities effectively without building knowledge base.

Figure 5-16 Structure of Proposed Infrastructure Project



They should obtain the following knowledge before starting its operation:

- Concept of private public partnership;
- Types of infrastructure open to private investment;
- Available PPP scheme;
- Procedure of PPP with and without government support;
- Risk sharing mechanism and available scheme in Indonesia; and
- Problems faced by investors; land acquisition, government support, tariff setting system, and so on.

The support of other agencies is indispensable to carry out this program successfully. There are two possible ways; one is to use the existing capacity building schemes organized by KKPPI, and the other is to have assistance from the donor community. If KKPPI provides seminars covering some of the above topics, BKPM should take part into them. If not, it seems to be difficult to have such trainings by only the effort of BKPM, and thus BKPM should seek any assistance from donor agencies.

3) Construction of a cooperative relation between the unit and KKPPI

The objective of this program is to develop the environment conducive to facilitate information exchange between the two organizations and to carry out promotion activities jointly. The candidate section of KKPPI for the cooperation is the Development Unit for Communications. The relations should be constructed by the following process.

a) Development of a regulatory framework on the cooperative relations

A decree should be introduced to entitle BKPM to engage into promotion activities of infrastructure projects. Such decree is expected to mitigate obstacles to developing the relations and to executing effective promotion activities by BKPM.

b) Identification of roles of the two organizations

The following table shows sample demarcation. The ad-hoc promotion means seminar, workshop, or conference and so on. The regular promotion implies investment consulting/advisory service. In this sample, BKPM is the key organization of the ad-hoc promotion activities in abroad and all regular activities with the support of KKPPI. Even though KKPPI has a function of promotion, it lacks knowledge, experiences, network, and capacity. We believe, therefore, it should be BKPM who takes prime responsibilities in conducting those promotion activities, except national level event such as Infrastructure Conference to be held in November 2006.

Type of promotion activities	BKPM	KKPPI
Ad hoc promotion (Domestic)	Main/Support	Main/Support
Ad hoc promotion (Abroad)	Main	Support
Regular promotion	Main	Support

c) Establishment of a mechanism to exchange and share information

It will be pointless if BKPM and KKPPI provide same information, and thus BKPM have to coordinate with KKPPI on the information to be disseminated through it. If KKPPI constructs a database of infrastructure projects covering completed, on-going, and prospective projects, what BKPM should do is to link to the KKPPI's HP concerned. Thus, BKPM should decide its coverage according to KKPPI's activities. There are some items which should be published by BKPM regardless of KKPPI's activities. One is the procedure of investment into infrastructure projects covering the procedure not only of a tender procedure but also of a company establishment. And the other is the sector profiles including risk and benefit to invest. The details of the two items are provided in Section 2.5.

4) Organize informal meeting with private sector

The objective of this program is to provide an opportunity to BKPM and private sector to exchange information. BKPM can hear opinion directly from private sector so as to obtain latest topics or technical information related to infrastructure projects. Since PPP to infrastructure projects is a new field for BKPM as well as the government, it is necessary to learn from experiences of private sector and to understand problems faced by investors. Such a meeting is expected to organize at least once a month. The topics to be presented on the meeting may be:

- Engineering
- Financing
- Contract

Instead of organizing such informal meetings by itself, BKPM may take part into Consolidated Indonesia Infrastructure Forum (CIIF) which is supposed to be established within 2006. The CIIF is expected to serve as the government's conduit for continue dialogue with the private sector on infrastructure development plans and projects. It should be more efficient for BKPM to participate in this forum than to organize meeting by itself when it is established. The informal meeting organized by BKPM, therefore, may become temporal place to exchange opinions until the forum is established.

5) Gather information related to infrastructure projects

This program aims at providing integrated information publication service through BKPM. Currently there is no organization that provides information covering all sectors'

infrastructure projects. Each line ministry is disseminating or will disseminate information related to own infrastructure projects only. KKPPI tries to store information and data covering all sectors, although its efforts have been stagnated because of the less cooperation of line ministries.

The cooperation of line ministries or responsible agencies and coordination with KKPPI are essential for this program. The institutions to be a partner of BKPM are:

- KKPPI
- Minister of Energy and Natural Resources
- Minister of Public Works including BPJT and SPPSPAM
- Minister of Transportation
- Minister of Information and Communication
- PLN
- Local Governments

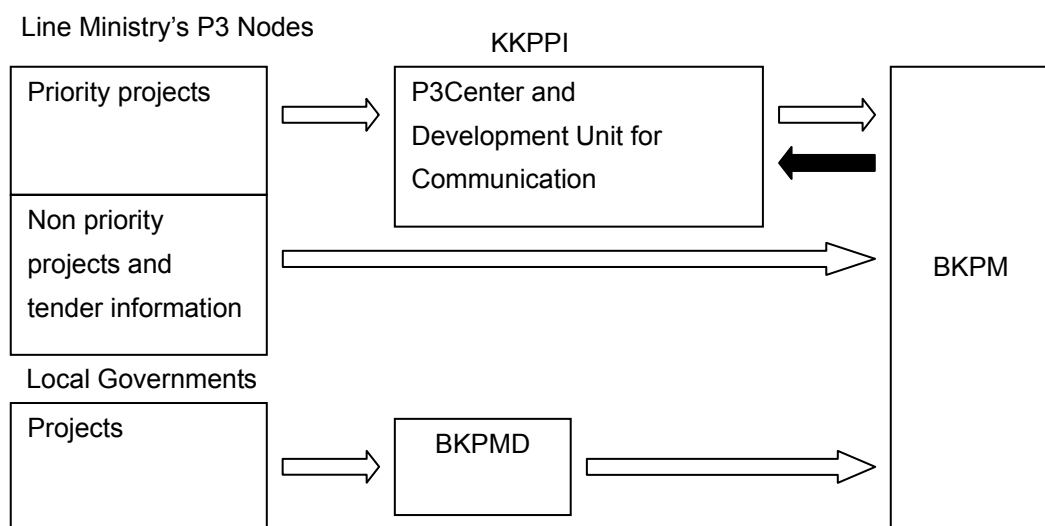
In order to establish those relations, the following issues are meant to be considered:

- How to collect information and data
- What kinds of information and data to be collected

a) How to collect information and data

There are three ways of possible information flows as shown in the following figure.

Figure 5-17 How to Collect Information and Data



(From line Ministries via KKPPI)

BKPM can access to the information on prospective projects with the support of KKPPI, because all prospective priority project information are gathered to P3Center of

KKPPI to evaluate their eligibility to grant government support. The information on completed and on-going projects as well as tender information, however, is kept by the organizations concerned, not KKPPI. And thus, BKPM should have collected them those organizations directly.

(Directly from line Ministries)

BKPM should establish information sharing mechanism with those line Ministries directly to collect information related to the projects without government support, so called non priority project. Those information are not available at KKPPI, because responsible line ministries are allowed to precede those projects without approval of Ministry of Finance. And thus, they are not necessary to submit that project information to KKPPI. 3) From local governments via BKPM

(From local governments via BKPM)

Local governments are responsible for implementing infrastructure projects such as water supply, local transportation, and so on. That project information can be collected through respective BKPMs.

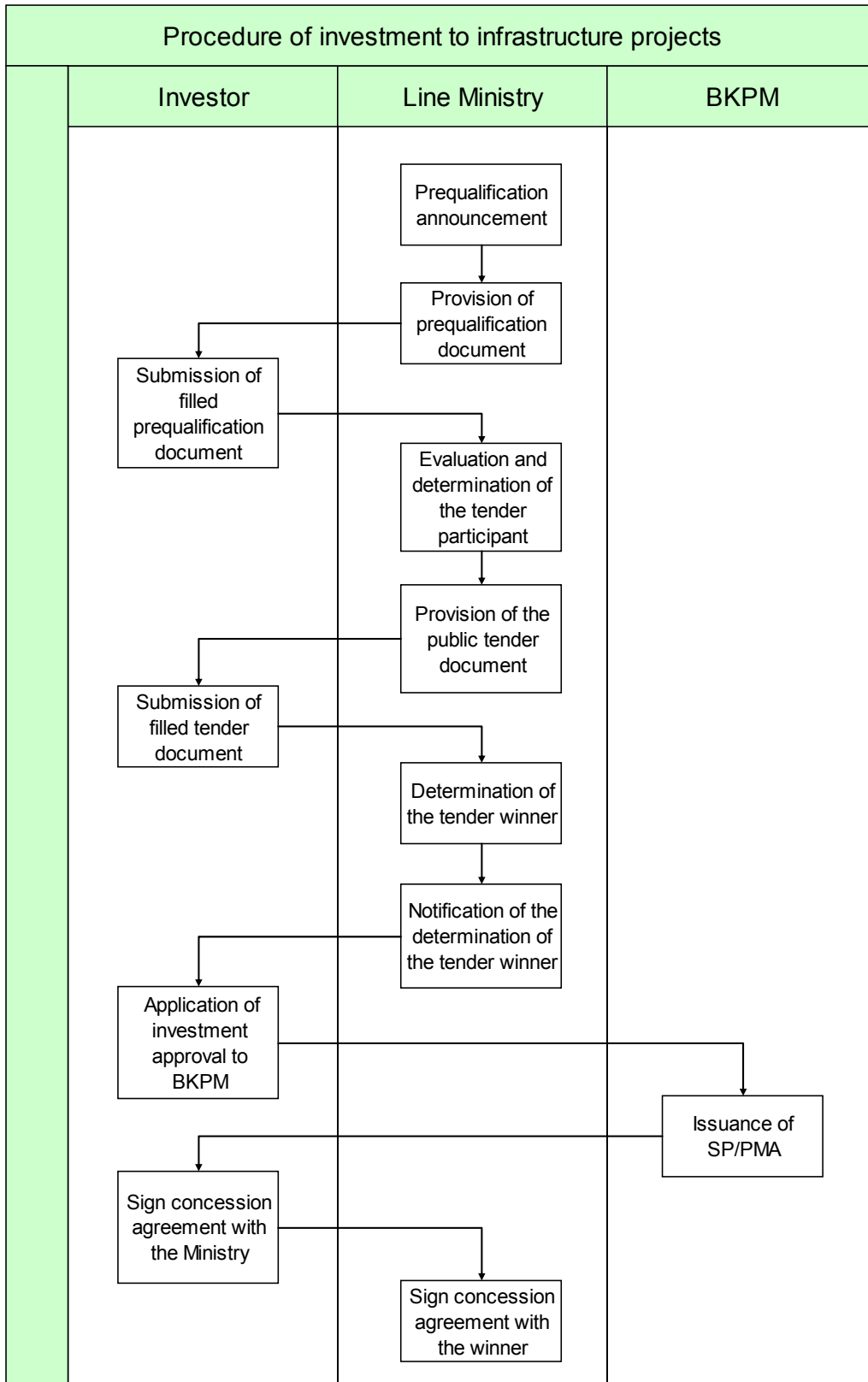
b) What kinds of information and data to be collected

(Investment procedure)

BKPM should provide an overall investment procedure covering from the tender process of the responsible ministry concerned to approval process of BKPM. The followings are sample procedure.

The flow includes three players; investor, line ministry, and BKPM. The investor is supposed to be a joint venture between a foreign company and a local partner. The flow starts from the tender process, followed by application of the investment approval to BKPM. In general, the company, who wishes to participate in a tender, is required to submit its Articles of Association as well as copy of NPWP (Tax-Payer Registration Number) in the pre-qualification stage. But, in case of a joint venture which has not been established yet, it is quite risky for the both of foreign and local company to establish a limited liability company before winning the bid. The parties to be composed of the joint venture, therefore, are only required to submit a copy of the partnership contract, and, after winning the contract, they have to establish a joint venture company to execute the project concerned.

Figure 5-18 Procedure of Investment to Infrastructure Projects



c) Sector profile

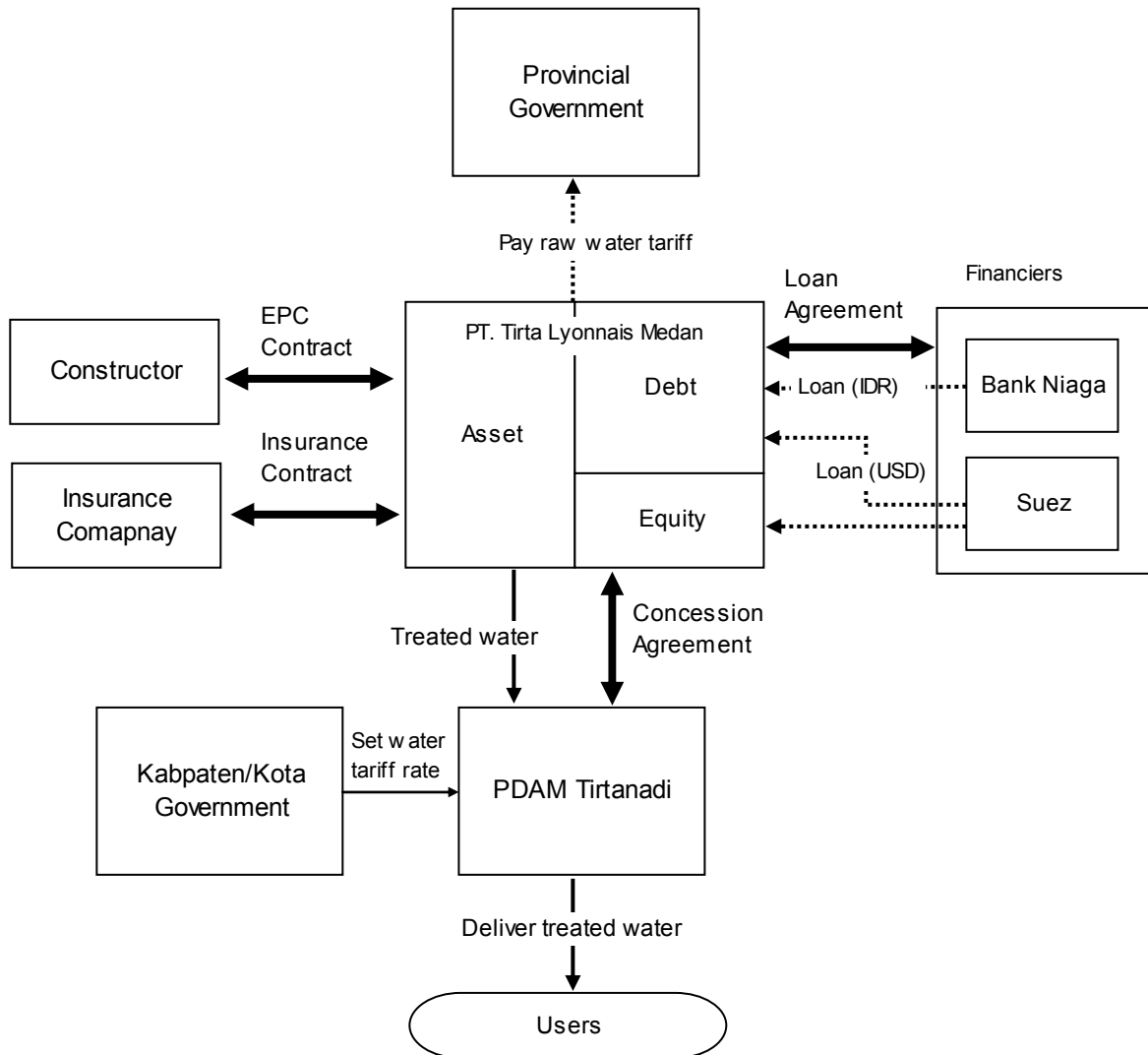
The profiles of each sector such as electric power, toll road, air port, water supply, and so on, are crucial information for potential investors to understand risk and benefit to invest into the project concerned. The following table is a sample profile of water supply sector.

Authority	Kabupaten/Kota Government	
Users	Residents of all income levels in the designated are	
Business Partner	PDAM	
Financial Engineering (1): Financial Resources	Bank loan (foreign currency, local currency) Bond (public bond, private placement bond, municipal bond)	
Financial Engineering (2): Financial Structure of the Private Operator	Revenues	Water tariff payment from PDAM
	Expenditures	Raw water expenses (12%) Manpower (12%) Chemical (11%) Maintenance (3%) Electricity (20%) Interest rate (12%) Depreciation (21%)
Market structure (potential and risk)	Potential	<ul style="list-style-type: none"> ➢ Stable demand (less competitive) ➢ Law cost of row material (raw water, Rp.10/ m³) ➢ Less land acquisition risk
	Risk	<ul style="list-style-type: none"> ➢ PDAM's weak and unsustainable financial position: <ul style="list-style-type: none"> ▪ ROA 1.76 ▪ ROE 4.38 ▪ Profit ratio 3.17 ▪ Capital Adequacy Ratio 40.23 ▪ Debt Equity Ratio 0.67 ▪ Growth Rate of Total Revenue 4.07 ▪ Growth Rate of Income from Operations -18.87 ➢ Increase in cost: electricity price, inflation, etc.

The procedures to collect and analyze such information are as follows.

- i. Draw project structure such as the figure below to find out where risks exist.
- ii. Examine the structure to identify risks (Political risk, project performance risk, Market (demand risk, Default risk, Force Majeure) and counter measures against them.
- iii. Analyze financial structure of business partner, PDAM.

Figure 5-19 Structure of The Sample Project

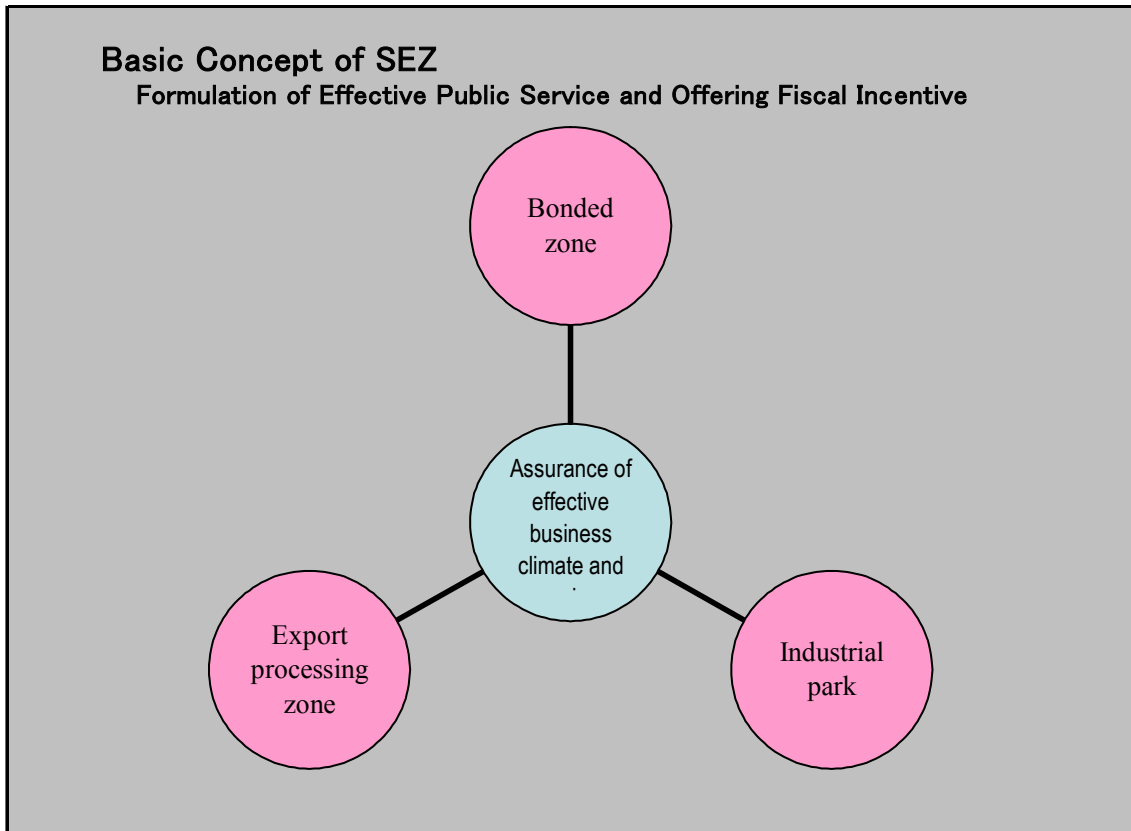


Source: JICA Study Team

5.5.1.4 Strengthening of Promotional Tools 2 (Development of Special Economic Zones as an investment tool)

The following figure indicates the standard structure of Special Economic Zone.

Figure 5-20 Basic Concept of Special Economic Zone



Source: JICA Study Team

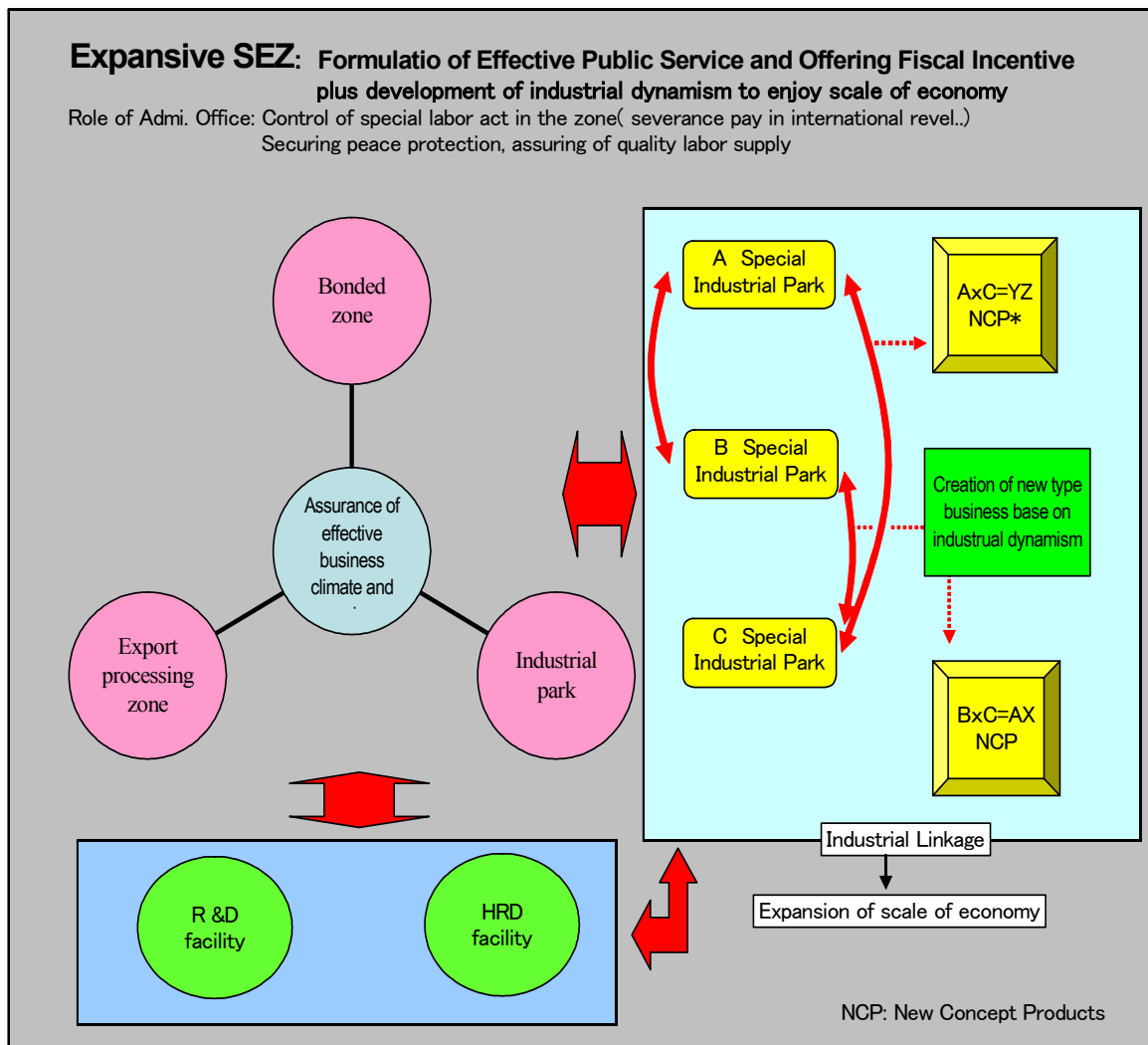
(1) Rationale

Expansive SEZ is a new concept economic zone that enables development of new products by cross-industrial cooperation effect and by efficient production resulted from strengthening of industrial globalization.

If a general purpose industrial estate could convert to a single purpose estate, tenant companies are able to enjoy good operational performance in terms of utility supply, common service facility, environmental control and volume purchase of raw materials. Also, further cost reduction can be realized if mutual cooperation among tenant companies is established. For instance, the possibility of producing new commodity (YZ) different from neither C-sector type nor A-sector type by mutual cooperation between A-SIZ (A- Special Industrial Zone) and C-SIZ.

There is no objection in the concept of the new investment law that will be enacted in near future. Rather, matters of concern of majority stakeholders are focusing in what and how minister's decree will be established.

Figure 5-21 Concept of Expansive SEZ



Source: JICA Study Team

Improvement of investment climate in the republic was the central argument since 1997. The argument has come to the conclusion stage to identify "how we can implement the most effective measure". And, as for the investment promotion, we came to the conclusion that it is better to propose a realistic plan rather than innovative or epoch-making plan.

(2) Purpose

The concept between expansive special economic zone (covering investment promotion, rural development and industrial concentration) and SEZ in front of Singapore economic zone (Batam, Bintan, Kalimun) differs completely. Development of SEZ at Singapore economic zone is simple, if we come up with the extreme logic.

Effective utilization of the local comparative advantages and local property maybe the effective and realistic strategy to develop SEZ at rural area rather than to develop it by luring a huge capital with special incentives. Since the case has a perspective of rural development in addition to the foreign capital promotion. Industrial promotion led by the local government at Southern and Eastern China could be a good practice. The reason why they succeeded in economic development was suggested by “Political centralization and economical decentralization. This means that the central government did not cut into the political administration at the area and was managed only by the local government. That is more to say that the real comparative advantage at the local level is well known by the rural government but the central government.

Moreover, if we learn from the historical truth, implementation of rural development using the existing industrial concentration system will provide various ancillary outputs. For example, business cost within the industrial concentration area maybe lower than outside the area. In addition, industrial concentration consist of various subsector (industrial dynamism) will be able to work out an efficient mutual cooperation among various subsector and lowers the production cost. Development of such mutual cooperation system could be an initial point for economic development.

It will be difficult to encourage potential investors with the current industrial concentration condition or business performance condition at the candidate SEZs nominated by the government.

(3) Project description

The following key word and development procedure comes to the idea as a definition of promotional strategy when we look into the change of the structure of the investment and industrial globalizm.

- ① Pay attention to the raw materials which has comparative advantage



- ② Examine whether the raw material can be converted to a secondary raw material that have a much boarder range of application (Palm oil for example, it can be converted to food additives, soap, bio-fuel and etc. after the extraction process).



- ③ Invite candidate investors who have technology and capital.

Aggressive promotion activity shall be done to invite candidate investors overseas through the following strategies:

- ▶ Provide proposal that consist of marketing analysis and the business model, etc.
- ▶ Make direct contact with the potential investors to offer special incentives
- ▶ Explain and describe the future projection of SEZ to encourage investors



- ④ Simultaneously, in order to accelerate industrial concentration in the SEZ surrounding area, propose depressed outskirts industrial estate to renovate as a special purpose industrial estate.



- ⑤ Organize “cross-industry association” with a collaboration from KADIN



- ⑥ Promote university-business alliance by connecting with the “cross-industry association”.

- ⑦ Promote establishment of R & D center

(4) Project scope

- 1) Set out any investment climate improvement measures which will increase the effect of economic efficiency of FDI.
- 2) Set out a development plan which enables sustainable economic effect by FDI.
- 3) The investment climate improvement measure that can cause the effect for sectors (spillover effect) than the sector that a foreign investment invested is designed.

(5) Implementation body

This project shall be executed by jointly with the following organizations:

Board member:

Ministry of public works (for erection plan)

- ▶ Ministry of industry (for development scheme preparation)
- ▶ Batam development board (for operational advise)
- ▶ BKPM (for facilitation of investment procedure and investment promotion)

scheme)

- ▶ Ministry of finance
- ▶ Ministry of trade

(6) Implementation schedule

1. Organize the board and implement the initial meeting: by the middle of
2. Drafting of development scheme
3. Setting up of the development plan
4. Development of layout plan
5. Preparation of promotional strategy
6. Implement promotion activity

activity	1 st quarter	2 nd quarter	3 rd quarter	4 th quarter
1				
2				
3				
4				
5				
6				

5.5.2 Development of Integrated Service System (Starting business level)

5.5.2.1 Three Years Plan for Realizing “Integrated Investment Approval Service”

(1) Background

Reportedly forthcoming New Investment Law proposes integrated investment approval service as one of major strategies for attracting foreign investors. Based on the results of our study in Investment Law, Negative List and Improvement of Investment Approval Procedure, what integrated service should be like and how to realize the service is proposed.

(2) Definition of “Integrated service”

Here, integrated service is defined as follows. It is to tie up various investment approval processes in one batch or line under one authority as much as possible. The purpose is to enhance investors’ convenience by making the procedure short and inexpensive.

(3) Importance of “Integrated service”

“Integrated service” is important for the following reasons.

- Most convenient to investors
- Time- saving to investors
- Low cost operation to investors
- Value creative operation to investors
- Problem solution process to investors
- Corruption free to investors

(4) Viewpoints taken into accounts in design of “Integrated service”

When “Integrated service” is designed, following viewpoints are taken into consideration

- To disperse concentrated economic activities in Jakarta to regional areas for balanced economic growth of Indonesia
- To take harmonization with regional development into account
- To take local specialties or conditions into consideration

(5) Four steps for realization

Integrated service is realized following four steps stated below.

1) To streamline each process at central governments and local governments

Target: 1) To reduce time consumed in each process by 30% in three years 2) To reduce variance of time in each process by 50% in tree years
--

● SP

(Target) To trim the time consumed by an investor in preparing “correct and proper “documents for SP

- Make Indonesian negative list transparent as much as possible
- Develop investor friendly procedure manual
- Delete not so important documents from submission list
- Set up a “Pre-processing of documents” section which helps investors to prepare documents: “A librarian ”
- Capacity building for officers at both front and back office for streamlining the operation (Detailed proposal is given in 2.3.7 Sources for Further Improvement (1)-5)

● SK

(Target) To reduce the time consumed by an investor and a notary public in preparing

necessary documents for SK

- Hold a regular communication meeting among Ministry of Justice, BKPM and Notary Public. The purpose is to share the “same” information on investment approval procedure and company registration.
 - Develop a “Fool-proof” system at Ministry of Justice
-

- Custom approval letters and IUT

(Target) To trim the time consumed by BKPM officers for issuing custom approval letters and IUT

- Shorten internal check at BKPM
-

- Local permits including TDP

(Target) To realize one roof service at every local government

- Proposed process
-

a) Analyze current operation flow in each local government

- Type of permits
- Number of permits by type
- Number of operation staff
- Flow of operation
- Organizational chart
- Management

b) Identify the problems in each operation faced by each local government

c) Identify several best practices among the above local government operations

- Batam SEZ
- Kudus
- Prepare etc.

d) Visit the above local governments with best practices and learn the key to success

e) Share the useful information collected in the course of the visit

f) Design the best scheme taking into account local conditions

- Concept
- Management style
- Organizational chart
- Allocation of staff
- Utilization of information technology
- Budget

g) Set a schedule for implementation

h) Hold a nation-wide seminar for implementation

i) Report making

2) To coordinate processes in parties concerned under a same principle through regular meetings among BKPM, Ministry of Justice, Notary Public and local governments

3) To establish a call-center at BKPM

(Purpose)

- Make it possible for investors to access BKPM for the purpose of knowing the current procedure of their projects through Internet
- BKPM connects their lines to other parties concerned through Internet
- Full-fledged tracking system
- In future, extend its service to receipt of investment application from investors' sites

4) To decentralize the entire process where it is necessary and possible to what extent decentralization proceeds depends on two factors. One is a possible change in registration process and the other is introduction of special investment promotion incentives. Both will be made clear within the next two years. Preparing for the Government's decision, following works should be conducted in advance.

- Development of several models fitting to different local conditions (Table 2-67)
 - Geography
 - Economic and industrial development
 - Natural resources
 - Governor's and mayor's initiatives

Table 5-4 Examples of Service Model

Model	Centralization or decentralization	Central permits	Local permits	Service
1. Batam SEZ type	Quasi-Decentralization	Central government at local office	Local government at local office	One roof for both central and local permits
2. Pure decentralization	Decentralization	Regional government at regional office	Local government at local office	One roof for central permits and one door for local permits
2- (1)				
2- (2)	Decentralization	Local government at local office	Local government at local office	One door for both central and local permit
3. Current type for all projects	Mix of centralization and decentralization	Central government at central office	Local government at local office	One roof for central permits and one door for local permits
4. Current type for only national and strategic projects	Mix of centralization and decentralization	Central government at central office	Local government at local office	One roof for central permits and one door for local permits

- Learn Batam SEZ's experience
- Capacity building for local staff in preparation of decentralization in issuance of SP

6) Implementation

A steering committee is organized with members of Coordinating Minister of Economy (chairman), BKPM, Ministry of Justice, Ministry of Trade, Ministry of Finance, Ministry of Home Affairs, Ministry of Manpower, BAPPENAS and each provincial government and several local governments.

An advisory committee is organized, too. The member consists of the following five persons, ex- central government officer, ex-local government officer, ex-corporate executive, ex-journalist and ex- professor at university. If matters difficult to solve occur, the committee suggests solutions at neutral position.

Besides the above two committees, a special project team is organized for the implementation. The outline of the team is as follows.

- a) Core member (total number is 12):
BKPM [2], Ministry of Justice [2], Ministry of Home Affairs [2], Local government [4],
Notary public [2]
- b) Chairman:
One of members from BKPM
- c) Mission:
To complete integrated service within three years
- d) Responsibilities
 - i) The team is given an authority to complete the service within the prevailing laws, decrees and regulations
 - ii) The team supports the implementation in each section concerned
- e) Whom to report
Chairman of BKPM

7) Financial and /or technical supports

Financial and/or technical supports will be provided by international donors such as World Bank, ADB and JICA, though the discussion with these organizations is not yet started.

indispensable to solve these issues. The Ministry of Manpower develops manpower policy based on the results of these studies.

Followings are examples of labor issues which need urgent solutions

- Severance pay
- Outsourcing
- Contract-based employment

In order to solve these issues, the following research is needed. Especially, the first one is important because the item is fundamental for designing solutions for all labor issues

- Analysis of current labor market affecting manpower policy
- National census on labor issues
- Comparative study in other nations
- Financial engineering

(2) Status and organization of the center

The center is an organization who could provide necessary information for the Ministry of Manpower to design manpower policy. The center should be a non profit, non governmental and neutral research institution. Research staff is invited from following institutions.

- Trade union
- Employers association
- University
- Research institute
- Ministry of Manpower

(3) Financial and / or technical supports

Since the proposed center deals labor policy matters, the Government extends some portion of funds. At the same time, employers association and trade unions contribute to the activities.

(4) Example of researches

1) Severance pay

a) Understanding severance pay's basic characteristics

Severance pay is a kind of compensation made to employees from employers for employees' inconvenience caused by dismissal, the reason which is not attributed to employees. The inconvenience in this context is following two. One is that against their expectation for stable employment, employees are suddenly dismissed and feel painful

damages. The other is that with dismissal, employees suddenly lose their way of earning money to sustain their daily life. They are not well prepared to such an event partly because the event suddenly occurs but partly because, in Indonesia, due to lack of unemployment social security system, employees are not well posed in hedging against the dismissal.

b) Composition of severance pay

If the above logic is reasonable and understandable, severance pay composes of two elements. One is just a compensation for sorrow of dismissal and is paid at a single rate. The other is a substitute for wages which is necessary to sustain daily life, thus, different by employees. Problem is how to fix the amount. Two factors are considered. One is the cost of living and the other is duration of unemployment.

c) Research activity

Main research activity is to analyze the average duration by employment years.

In order to get exact information, it is necessary to conduct regularly national survey for unemployed people. By doing so, it becomes possible to speculate the duration.

Major outputs are as follows.

- Distribution of duration for finding next job after dismissal by area, age group and education level
- Severance pay model constructed on the basis of the above distribution

d) Study in possibility of incorporating severance pay to social security system

In case of transition to social security system, followings are to be deeply studied.

- Type of pays to be covered: Does it include reward pay and compensation pay?
- Employee to be covered: Should outsourcing and contract-based employees are covered?
- Characteristics of scheme: Insurance or saving?
- Contribution rate by employer and employee

In deciding the above, case studies in other countries are also conducted.

In case transition to social security system is determined, financial engineering activities are done concentrating on risk pooling scheme, cash flow analysis, and risk hedge scheme and computer science.

2) Other research areas

- Changes in labor market
 - Areas where job are created
 - Recent features of job creation

There are no other neighboring countries imposing this kind of tax. Therefore, if Indonesia abolishes this tax, the positive foreign investors will be convinced that Indonesia finally becomes the same as other countries in terms of the investment conditions.

(2) Purpose

- To avoid vexatious ness for foreign taxpayers
- To announce the changes in the Indonesian taxation system
- To remove the breeding ground for corruptions
- To reduce the prepaid tax items.

(3) Expected outcomes of the Project

No need of fiscal exit tax windows and check counters at airports.

Expatriates working for an Indonesian company and their family members will be able to leave Indonesia smoothly. After all, living conditions in Indonesia of foreign investors will be improved.

(4) Project descriptions

The tax law should be amended. So a bill for the amendment should be submitted to the Diet. It is assumed that the Indonesian government is afraid of a drop in tax revenues following a decline in the tax revenues' ratio to its GDP, if fiscal exit tax is abolished. That is the reason why the government seems unwilling to abolish this tax despite demands from various business groups for the abolishment. The concept lying behind fiscal exit tax that the individuals leaving for overseas must be wealthy and can afford to pay such tax is completely out of date.

This tax is regarded as a prepaid tax. Therefore, if the Indonesian tax collection system is better organized, fiscal exit tax can be collected as personal/corporate income tax at later times, not exactly when leaving the country. In other words, this is an issue of the tax collection procedure covering from an individual's departure for overseas, his declaration of fiscal exit tax, to his payment of the tax; and improvement of the tax collection system will not require much burden of costs.

The Indonesian government should become aware of this vicious circle that the more the government is persistence with maintaining the current tax collection system, which is based on an old-fashioned concept of "collect as much tax as possible from those who can afford to pay", the more the taxpayers become unwilling to pay taxes. It is a fair statement that the Indonesian government shall abolish the fiscal exit tax so as to resolve this vicious circle and to get its taxation system back to basics of duly collecting taxes from those who have made

profits.

Despite the government announced its plan to abolish this tax by 2010, it is strongly recommended that the abolishment shall be done as soon as possible. It is because Indonesia has long been at the turning point for a change for encouraging more investments in Indonesia by positive-minded prospective investors.

(5) Competent authority and financial sources

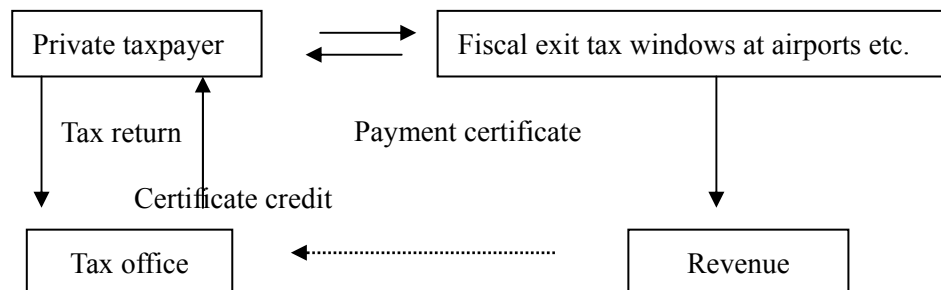
Ministry of Finance shall take initiative for implementation.

The fiscal exit tax is a prepaid tax and it can be credited as part of income tax payable, when a taxpayer claims for tax return. Therefore financial sources for changing the taxation system depend on how to manage cash flow in the national treasury; and there is no need for the funds specifically allocated for this Project.

Moreover, because the Indonesian government already declared its plan for the abolishment of this tax by 2010, any governmental bodies concerned may begin their work toward the abolishment far ahead of the original schedule.

(6) Proposed taxation structure

Figure 5-24 Fiscal Exit Tax



Abolishment of fiscal exit tax

By the abolishment, the tax office will also be able to reduce its burden of office duties, and thereby to allocate excess personnel to its other sub-divisions or other governmental agencies.

(7) Activities

Prepare amendment proposal of fiscal exit tax regulation.

The fiscal exit tax section ceases to exist.

(8) Expected benefit of the project

This project will make foreign investors well aware that Indonesia becomes a modern country in terms of the taxation. The personnel in the fiscal exit tax section can be transferred to other sub-divisions of the tax office or other governmental agencies.

(9) Weakness of the project

One prominent unsolved issue in the project is that financial sources for changing the taxation system depend on the management of cash flow in the national treasury. Therefore, the tax office must closely negotiate with the Ministry of Finance.

5.5.3.3 Abolishment of PPH22 of Prepaid Income Tax for Imported Goods

(1) Rationale

Indonesia is the only country that imposes the prepaid income tax on importers for each of their import. This maybe comes from the notion that “a company intending to import goods from abroad usually must have enough profits to pay the Income tax in advance at the time of import.” But this notion has not been acceptable to positive-minded foreign investors. And this prepaid tax system has also been a burden to foreign taxpayers, requiring them of 5 man-days of extra work per month. Moreover, there is no other country that imposes the same kind of tax. Therefore Indonesia must abolish this tax.

(2) Purpose

1. To avoid vexatiousness for foreign taxpayers
2. To reduce tax and customs office’s clerical work.
3. This tax is managed by customs office on consignment from tax office.
4. To announce the changes in the Indonesian taxation system
5. To remove the breeding ground for corruptions
6. To reduce the prepaid tax items

(3) Expected outcome of the project

Foreign investors in Indonesia, especially export-oriented manufacturers, can easily import raw materials from abroad. This is expected to help increase the export competitiveness of Indonesian products. And increased imports are also expected to promote active financial transactions based on such imports.

(4) Project description

The tax law should be amended. So a bill for the amendment should be submitted to the Diet.

It is assumed that the Indonesian government is afraid of a drop in tax revenues following a decline in the tax revenues' ratio to its GDP (i.e. 12.7%), if the PPH22 of prepaid income tax for imported goods is abolished. That is the reason why the government seems reluctant to abolish this tax despite demands from JJC and other various organizations abroad for the abolishment. The notion lying behind this tax that the government should not miss every opportunity for collecting taxes from those who make profits from or through imports is completely out of date. Not all the companies importing goods from abroad necessarily earn profits out of or through imports.

This tax is regarded as a prepaid tax. Therefore, if the Indonesian tax collection system is better organized, the tax on import goods can be collected eventually as part of personal/corporate income tax, without being required for prepayment at the time of import. In other words, this is an issue of the tax collection procedure covering from each import by an individual or company, his or its declaration of the tax, to his or its payment of the tax; and improvement of the tax collection system will not require much burden of costs.

The Indonesian government should become aware of this vicious circle that the more the government is persistence with maintaining the current tax collection system, which is based on an old-fashioned concept of "collect as many taxes as possible by grabbing every opportunity", the more the taxpayers become unwilling to pay taxes. The Indonesian government should realize that tax consultants in Indonesia are busy with advising on how to avoid any tax payments. It is a fair statement that the Indonesian government shall abolish this tax so as to resolve this vicious circle and to get its taxation system back to basics of duly collecting taxes from those who have made profits.

Despite the government announced its plan to abolish this tax by 2010, it is strongly recommended that the abolishment shall be done as soon as possible. It is because Indonesia has long been at the turning point for a change for encouraging more investments in Indonesia by positive-minded prospective investors.

(5) Competent authority and financial sources

Ministry of Finance, Indonesia

Financial sources for changing the taxation system depend on how to manage cash flow in the national treasury.

(6) Activities

The procedures for imposing the customs withholding tax will cease to exist.

So the customs office can transfer the excess personnel to other sub-divisions or other governmental agencies.

(7) Expected benefits of the Project

The burden of work for taxpayers, the tax office and the customs office will be reduced.

(8) Weakness of the Project

One prominent unsolved issue is that financial sources for changing the taxation system depend on the management of cash flow in the national treasury. Therefore, the tax office and the customs office must closely negotiate with the Ministry of Finance to realize the abolishment of this tax as soon as possible.

5.5.3.4 Establishing an Early VAT (value added tax) Refund System

(1) Rationale

According to the applicable regulations in Indonesia, an approval for refund of VAT shall be given within the following periods from each claim for the refund:

- 1) In case of claim by specific, competent taxpayers: --> 1 month
- 2) In case of claim by exporters or those who pay VAT through a "VAT collector", excluding those taxpayers mentioned in 1) above: --> 2 months
- 3) In case of claim by other taxpayers than those mentioned in 1) and 2) above: --> 6 months
- 4) In case where the tax authorities investigate all kind of tax decision on approval or denial of the refund must be made within 12 months in any case.

- Except the case of 1) above, the results of the investigation by the tax authorities into the refund claim must be reviewed before any refund of VAT is made.
- Generally it takes about one year or so for the refund to be completed. However, only a limited number of large enterprises, which have adopted the "Modern Tax Administration System" – a computerized tax processing system being promoted by the tax bureau, enjoy timely refund of VAT, whereas small and medium-sized enterprises still have some difficulties in getting their VAT refunded.

(2) Purpose

Early VAT refund system is expected to give solutions to the following problems which foreign taxpayers are now facing.

Taxpayers, who export 100% of their products overseas, are not subject to the output VAT but are subject always to the input VAT. Therefore the output VAT prepaid by those taxpayers (exporters) must be refunded to them on a regular basis (ex. monthly or annually);

and those taxpayers must go through the tax audit for their output VAT refund. That means that such taxpayers are made to incur unnecessary losses from following the current VAT refund procedure, such as losses from raising fund for prepayment of output VAT and interest on the raised fund, in addition to time loss and negotiation loss because of the tax audit.

This situation affects the competitive power of export-oriented companies.

- 1) According to the applicable regulations in Indonesia, in case where a taxpayer pays royalty to an overseas company and where the taxpayer is not required to pay input VAT on behalf the overseas company, VAT already paid by such taxpayer can not be refunded. It means that when such a taxpayer intends to pay royalty in the amount of US\$100-, he must spend US\$110.0. Meanwhile, when such a taxpayer pays withholding income tax on PPH26, the payment does not affect his cash-flow directly because he may deduct an amount equivalent to the withholding income tax when making payment. However, in case of payment of VAT, it affects the taxpayer's cash-flow immediately, although the refund of VAT may be made in the future.
- 2) In case where a taxpayer receives a commission in consideration for a certain service that he has provided, such service shall be regard as free from any added values in Indonesia because there are no specific regulations in Indonesia in this regard. Therefore the taxpayer usually treats the received commission as a miscellaneous income account. However, tax officers often try to impose VAT on such commission by insisting on ungrounded reasons.
- 3) In particular, newly incorporated companies are adversely affected by the current VAT refund system. It is because that such a company usually must pay a large amount of input VAT when it is still at the start-up stage, for purchase of land, facilities and machinery etc. required for starting its business. This has become a major obstacle in inviting prospective investors into Indonesia.

Each PDKB (Pengusaha di Kawasan Berikat; bonded factory) must pay VAT on the services it has rendered, although VAT is not imposed on its materials and goods cleared through customs. This is ludicrous from the viewpoint that PDKB system is established in order to invite more and more export-oriented investors into Indonesia, because naturally PDKB does its business mainly by performing a wide-ranging services, such as repair, subcontracted product processing, accounts auditing and consulting, but not by merely moving goods and materials through customs. This current PDKB system is ruining the competitive power of export-oriented companies.

(3) Expected outcomes of the Project

The tax audit in Indonesia is very notorious. Almost no claims for tax refund have been duly approved and performed in terms of their amounts and timing. As already mentioned in

2. Purpose above, problems associated with the VAT refund are wide-ranging.

Nevertheless, Thailand, Vietnam and the Philippines, which are rivals of Indonesia in the efforts for inviting foreign investments, still have similar VAT refund-related problems. Therefore, if Indonesia takes a lead over these countries in establishing a better organized VAT refund system, Indonesia will surely be able to see positive results of much more increased number of foreign investors coming into Indonesia.

(4) Project descriptions

Peraturan Direktur Pajak Nomor Per -122/PJ/2006, a directive by the head of the Indonesian tax authority concerning the overpaid VAT refund system, was issued on August 16, 2006. This directive contains not many significant changes except one; that is, this directive clearly sets forth a provision that, for the time being, overpaid VAT should be refunded within 2 months from the receipt of each claim from a taxpayer.

However, this directive still contains the provisions regarding sever penalties for any tax cheating and provisions regarding the tax audit, the notorious procedure required for approval of any VAT refund. And taxpayers may claim for VAT refund only once a year

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However, this directive still contains the provisions regarding sever penalties for any tax cheating and provisions regarding the tax audit, the notorious procedure required for approval of any VAT refund. And taxpayers may claim for VAT refund only once a year.

Therefore, it is assumed that export-oriented companies in Indonesia will remain unsatisfied with the VAT refund issue because that their obligation to pay VAT in advance affects their cash flow.

It is no doubt a big step forward that the head of the tax office in Indonesia declared that VAT refund shall be performed within 2 months from claim for refund. Expectations are running high for VAT refund to be smoothly proceeded as promised by this declaration, unlike the cases in the past where slogans remained just slogans or where situations got even worse.

If Indonesia fails to implement this directive, the government will lose face and surely be abandoned by prospective foreign investors.

Furthermore, it is important to change the system of evaluating respective tax offices. Under the current system, any tax officer who has refunded VAT in response to refund claims is given a minus point in his performance appraisal. Therefore, each tax office tends to minimize VAT refund as much as possible in order to improve its overall appraisal rating.

Some of the companies interviewed for this report revealed that their tax office takes more long time now for VAT refund, despite use of the Modern Tax Administration System (however, they also pointed out that a good outcome of the introduction of the System is that they can now be able to negotiate with specific tax officers in charge of VAT refund issues). It is strongly recommended that such appraisal system shall be abolished in order to avoid delay in approving any refund of VAT.

(5) Competent authority and financial sources

Ministry of Finance, Indonesia

Financial sources for changing the taxation system depend on how to manage cash flow in the national treasury, although special funds must be secured in the budget for increased introduction of the Modern Tax Administration System in tax offices. In particular, the Ministry of Finance announced its plan to secure a special budget for introducing the Modern Tax Administration System in those tax offices which deals mainly with PMA (foreign owned enterprises in Indonesia) in 1 to 2 years. The tax authority shall continue to cooperate with the Ministry of Finance to have the budget allocated for the Modern Tax Administration System in the Diet.

(6) Proposed taxation structure

The tax authority shall continue promoting the current reform efforts so that the taxation on PMA will be handled in a simplified manner by a single tax office.

(7) Activities

The Modern Tax Administration System and e-payment of taxes through the System must be made available not only to large enterprises but also to small and medium-sized companies.

(8) Expected benefits of the Project

If successfully established, the early VAT refund system will help increase the competitive power of export-oriented companies and their products as well as cash flow efficiently of such companies

(9) Weakness of the Project

One prominent unsolved issue is that financial sources for changing the taxation system depend on the management of cash flow in the national treasury. Therefore, the tax office must closely negotiate with the Ministry of Finance.

5.5.3.5 Reduce the Number of Installments of Prepaid Income Tax

(1) Rationale

In Indonesia, all the income tax on previous year's earnings must be prepaid in 12 installments, each in every month. This frequency seems the highest compared to the cases in its other neighboring countries. This frequency and the complexity of clerical work associated with paying income tax in 12 installments have become a burden to taxpayers.

The Indonesian government must take appropriate measures to solve this problem.

(2) Purpose

1. To ease the burden on taxpayers of performing clerical work for payment of income tax every month
2. To ease the burden of duties at tax offices and thereby to allocate excess personnel to its other sub-divisions or other governmental agencies.

(3) Expected outcomes of the Project

Efficiency in companies business operations will be increased, thereby help improving competitive power of Indonesian products.

(4) Project descriptions

It is ideal in theory that the current prepaid income tax system ceases to exist. However, it seems impossible to remove this prepaid system all at once and establish a new ideal income tax system, when considering the current inefficient collecting tax system deeply-rooted in Indonesia.

In addition, the prepaid income tax system is rather convenient for some companies which do not have enough cash flow to pay a large amount of income tax all at once.

Therefore, it is hereby recommended that the payment frequency be reduced to 3 to 4 times a year from 12 times in order to reduce the work burden on both taxpayers and tax offices. It is ideal that each taxpayer shall eventually be given the right to make its own decision on the payment frequency

(5) Competent authority and financial sources

Ministry of Finance, Indonesia

Financial sources for changing the taxation system depend on how to manage cash flow in the national treasury.

The Indonesian government seems afraid of a drop in tax revenues following a decline in the tax revenues' ratio to its GDP (i.e. 12.7%), if the system of prepaying income tax in 12 installments is abolished. That is the reason why the government seems reluctant to abolish this taxation system despite demands for the abolishment from JJC and other various organizations abroad.

The notion lying behind this system is that the government should collect taxes even in advance, rather than missing a tax-collection opportunity at a later date. All the income tax on the previous year's earnings must be prepaid; and in case of excess payment, the claim for the refund of such excess payment shall be subject to going through the notorious tax audit. As a result, companies have established the accounting procedures to render as small earnings as possible; and this is believed to have caused indirectly a further drop in the tax revenues' ratio to GDP.

This income tax paid in 12 installments is regarded as a prepaid tax. Therefore, if the Indonesian tax collection system is better organized, the tax can be collected eventually as personal/corporate income tax. In other words, this is an issue of the tax collection procedure covering from each monthly prepayment by an individual or company, his or its declaration of income tax, to his or its payment of the tax; and improvement of the tax collection system will not require much burden of costs.

The Indonesian government should become aware of this vicious circle that the more the government is persistence with maintaining the current tax collection system, which is based on an old-fashioned concept of "collect as many taxes as possible by grabbing every opportunity", the more the taxpayers become unwilling to pay taxes. The Indonesian government should realize that tax consultants in Indonesia are busy with advising on how to avoid any tax payments. It is a fair statement that the Indonesian government shall abolish this prepaid tax system so as to resolve this vicious circle and to get its taxation system back to basics of duly collecting taxes from those who have made profits.

Despite the government announced its plan to abolish this prepaid tax system by 2010, it is strongly recommended that the abolishment shall be done as soon as possible. It is because Indonesia has long been at the turning point for a change for encouraging more investments in Indonesia by positive-minded prospective investors.

(6) Proposed taxation structure

The taxation structure will remain unchanged.

(7) Activities

Amendment of the tax law. So a bill for amendment should be submitted to the Diet.

(8) Expected benefits of the project

Efficiency in companies' business operations will be increased, thereby help improving competitive power of Indonesian products

(9) Weakness of the Project

One prominent unsolved issue is that financial sources for changing the taxation system depend on the management of cash flow in the national treasury. Therefore, the tax office must closely negotiate with the Ministry of Finance to secure enough funds.

5.5.3.6 Rationalization of "One Day Customs Clearance"

(1) Rationale

Neighboring rival countries such as Thailand and Vietnam have been very successful in speeding up their customs clearance procedures; and Indonesia have fallen far behind of these countries. Therefore Indonesia must improve efficiency its customs clearance system as soon as possible.

(2) Purpose

To eliminate imputation of Indonesia's customs clearance system

(3) Expected outcomes of the project

A new law or regulations or amendments to the current law or regulations will be enacted, which are aimed to introduce a computerized customs clearance system handling wide-ranging electric transactions such as digital signatures and electric exchanges of documents.

Such computerized customs clearance system shall be interconnected and integrated with the EDI (electronic data interchange) system already running in Indonesia.

(4) Project description

Make a slogan, for instance, "one day customs clearance" and create an environment

where all the parties concerned will be able to transact the customs clearance procedure quickly and efficiently through the computerized system, and other means.

(5) Competent authority and financial sources

Directorate General of Custom and Excise, Indonesia

Special funds must be secured in the budget for installation and operation of the computerized customs clearance system.

(6) Activities

1. Drafting of a bill for establishment of a new law or regulations or for amendments to the current law or regulations regarding electric transactions of the customs clearance procedure such as digital signature and electric exchange of documents.
2. Installation of a computerized customs clearance system interconnected and integrated with the existing EDI.

The EDI currently used for customs clearance transactions in Indonesia deals only with shipping information, and the EDI system is not interconnected with other online databases of ministries and other government agencies in Indonesia. Therefore, in case where the goods are hazardous or chemical materials, for example, the importer must visit the Ministry of Technology or an agency in charge of drugs or other competent authorities to obtain approval of said goods and must submit an original copy of the approval to the customs bureau by hand delivery.

Although united efforts are being made among ASEAN countries for the establishment of a one-window customs clearance system covering all ASEAN countries, Indonesia seems to require more time to become ready for introducing such system.

Therefore, it is hereby recommended that Indonesia shall, as a first step, begin with drafting of new laws and regulations for facilitating electric transactions and with installation of the computerized customs clearance system encompassing the current EDI and various government agencies' databases.

(7) Expected benefits of the project

Competitive power of foreign investors, especially who import goods and materials into Indonesia, will be increased.

(8) Weakness of the project

According to a report issued by the University of Indonesia, Indonesian customs bureaus are responsible for only 20% of various causes of delay in the customs clearance procedure.

Therefore, for speed-up of the procedure, ideally in “one day”, a unified, well-organized structure involving the computerized customs clearance system, the EDI, and government agencies’ databases all together is required, in which all the parties will be able to work closely.

5.5.3.7 To Promote the Transparency in Tax Audit and Customs Clearance Inspection

(1) Rationale

The tax audit and customs clearance inspection procedure in Indonesia are notorious because:

- 1) Although sound laws and regulations concerning the customs inspection system are already established, there are still many gray areas as to interpretation and application of certain provisions of applicable laws and regulations in performing the tax audit and customs inspection procedure.
- 2) Such interpretation and application of certain provisions in those laws and regulations are very different depending on respective tax auditors and customs officers.

Tax auditors and customs officers have enormous discretionary power over such interpretation and application of the provisions concerned.

These circumstances are breeding ground for corruptions. That is, tax auditors and taxpayers or customs officers and importers/exporters, as the case may be, tend to seek for “win-win resolutions” for both through backdoor negotiations. Taxpayers or Importers/exporters, as the case may be, tend to think that bribing officers is a necessary evil in order to minimize its financial and time loss incurred from unproductive discussions with them, whereas tax auditors or customs officers, as the case may be, tends to think that they can earn extra money by turning a blind eye to possible problems with the companies or imported/exported goods concerned, as the case may be.

(2) Purpose

To increase transparency in taxation and customs clearance systems in Indonesia

(3) Expected outcome of the project

Preparation of a guidebook setting forth precedents for tax and customs officers

(4) Project descriptions

- Start preparing the guidebook containing case-by-case precedents. And distribute the guidebook to tax and customs officials for their use in their duties as a reference

material.

- Re-educate tax and customs officials so that they perform their duties strictly following the specific standards (precedents) set forth in the guidebook.

(5) Competent authority and financial source

Ministry of finance and Directorate General of Custom and Excise, Indonesia

No need for a large amount of financial sources for preparation of the guidebook.

(6) Activities

1. Preparation of the guidebook containing case-by-case precedents. And distribute the guidebook to tax and customs officials for their use in their duties as a reference material.
2. Re-educate tax and customs officials so that they perform their duties strictly following the specific standards (precedents) set forth in the guidebook.

(7) Others

Contents of the guidebook for tax and customs officers

a) Provisions of the Tax Code and Customs Law

b) Detailed enforcement regulations

c) Relevant provisions

d) Specified “gray areas”

Precedents of interpretations and judgments regarding “gray areas”

5.5.3.8 To Establish a Modern Bonded Area System (to be developed within the framework of 5.5.1.4)

(1) Rationale

To increase the competitive power in terms of costs of export-oriented industries, many countries, including Indonesia, have adopted the bonded area system. Export-oriented companies in Indonesia are therefore allowed to build a bonded factory/warehouse in specified bonded areas in Indonesia.

The law concerning the bonded area system in Indonesia is based on the ministry decree dated June 26, 1997 (No.291/KMK/1997) as well as the enforcement regulations in the directive issued by the Director General of the tax office on July 25, 1997 (KEP-63/BC/1997). This law changed the definitions of EPTE (bonded factory) and EPZ (bonded Area) to PKB (administrator of bonded area) and PDKB (business operator/factory in bonded area). The definitions regarding the bonded warehouse remain the same; PGB (administrator of bonded warehouse) remains an administrator and PPGB (warehouse operator in bonded area) remains

an operator.

(2) Purpose

Reform the bonded area system in line with recent developments in trade transactions.

(3) Expected outcome of the project

Modification of the law concerning the bonded area system

(4) Project descriptions

The law concerning the bonded area system shall be modified to allow the following items, modeling after Batam Island.

- 1) PDKB (factory in a bonded area) shall be exempted from paying VAT on services. Currently, each PDKB (factory, or in case of warehouse as well, in a bonded area) is obliged to pay VAT on the services it has rendered, although VAT is not imposed on its materials and goods cleared through customs. This is ludicrous because naturally PDKB does its business mainly by performing wide-ranging services, such as repair, subcontracted product processing, accounts auditing and consulting, but not by merely moving goods and materials through customs. This current PDKB system is ruining the competitive power of Indonesian products.
- 2) To bring goods procured inside Indonesia into PPGB (warehouse in a bonded area) shall be allowed.
- 3) The transfer of goods between PPGBs shall be allowed.
- 4) The transfer of goods from PDKB to PPGB shall be allowed.

Under the current Indonesian bonded area system, bonded warehouses are regarded as used only for the purpose of supplying imported goods, but not locally procured goods, to bonded factories. This system is not suited to today's various transactions taking place in bonded areas.

(5) Competent authority and financial sources

Directorate General of Custom and Excise, Indonesia

No need for financial sources

(6) Proposed changes in the organizational structure

There is no need for any change in the organizational structure, but certain amendments shall be made to the law concerning the bonded area system.

(7) Activities

- 1) To amend the law concerning the bonded area system, modeling after Batam Island

- 2) To exempt PDKB from paying VAT on services
- 3) To allow goods locally procured to be brought into PPGB
- 4) To allow transfer of goods between PPGBs

(8) Expected benefit of the project

The efficiency as well as volume of transactions in bonded areas will be increased.

Attachment

Attachment 1 Project to Strengthen Promotion Function of BKPM

**Attachment 2 Scope of Work of the Study on Realization of
“Integrated Service”**

**Attachment I Project to Strengthen Promotion
Function of BKPM**

Attachment 1 Project to Strengthen Promotion Function of BKPM

(Draft Scope of work for strengthening of research function of BKPM)

Based on the recommendation submitted by the JICA Study Team on “Improvement of Investment Policy in Indonesia”, we, BKPM, would like to propose a new project to develop a practical mechanism to improve task performing capability.

1. Objective of the project:

The objective of the project is to improve promotional capability of BKPM to realize effective and successful investment promotion.

2. Background of the project

Promotion is the core function of BKPM other than the investment approval services. However, promotion activity has not been done effectively because the organization structure and project operation structure is not functioning well. And the current organization structure is not well applying to catch up with the world investment trend.

3. Target area of the project:

In order to achieve the said objective, the following activities and consulting services has been implemented:

3.1 Development of effective data collection and compiling function for:

- (1) World direct investment trend
- (2) Asian and pacific investment trend
- (3) Position of Indonesia in manufacturing globalization
- (4) Investment climate of Indonesia
- (5) Comparative advantages in manufacturing and servicing sub-sectors

3.1.1 Practical activity to attain the project targets as identified in 3.1

- ▶ Review the current system to obtain investment relating data

- ▶ Review and evaluate the existing application form such as SP for more promotion purpose rather than approval
- ▶ Identify availability of necessary data
- ▶ Review and evaluate the current data analysis system and output
- ▶ Review the current method to setting-up investment promotion strategy
- ▶ Review and evaluate the target and concept of existing promotion tools
- ▶ Review the current method to prepare promotion tools

3.2 Establishment of research and analysis division for:

- (1) Investment priority areas and sectors identification
- (2) Investment strategy development
- (3) Investment priority areas identification
- (4) Business performance analysis (SWOT analysis for business performance)

3.2.1 Practical activity to attain the project target as identified in 3.2, above

- ▶ Identify the availability of necessary data
- ▶ Establish obtaining channel or method of necessary data in constant basis
- ▶ Establish cooperative relationship with outer institutions such as JETRO, JFC, JBIC, etc.
- ▶ Implement business performance indicator analysis as a case study
- ▶ Development of taskforce to associate IPP development board
- ▶ Call on or coordinate to associate IPP jointly with various ministries concerned
- ▶ Formulation of regular meeting with foreign business organizations (i.e. JJC, KOTRA, Australian Chamber of Commerce, Taiwanese's Chamber of Commerce, Chinese commercial attaché, etc)

3.3 Capacity building activity to promote BKPM officials in terms of:

- (1) Risk analysis in FDI project
- (2) Concept to develop business plan
- (3) Theory of investment behavior
- (4) The world investment trend and position of Indonesia

3.3.1 Practical activity to attain the project target as identified in 3.3, above

- ▶ Implement risk analysis as a case study

- ▶ Implement seminar for capacity building (business plan development¹, direct investment behavior, the world direct investment trend, etc.)
- ▶ Target number of staff to be trained: 30
- ▶ Duration of Training for one seminar: Two weeks. One class consist 15 trainees. Gross duration of the seminar will be 6 weeks.

4. Expected project output

The following output will be obtained.

- (1) New promotion strategy and promotional tools based on quantitative analysis.
- (2) Questionnaires or data analysis tools to be used for developing promotional strategy
- (3) New section that has research and analysis function
- (4) New organization structure which can implement promotion activity more effectively.
- (5) Collaboration or linkage with external organizations to compensate necessary data to identify world investment trend and which are not covered by self-effort of BKMP now.
- (6) Completion of capacity building to promote BKPM staff to understand business performance requirement and investors needs.

5. Proposed assignments of consultant

- ▶ Marketing specialist
- ▶ Business climate analyst
- ▶ Human resource development and organization specialist

6. Prerequisite of the project

In order to get fruitful success of the project, BKPM is requested to assign **fulltime** taskforce members. This is indispensable condition to implement the project.

¹ (Character of businesses, business competition analysis, market analysis, business schedule, purchasing and production activity, financial analysis and business viability, etc.)

7. Work schedule

Initial study (preparing for the implementation of practical improvement activity starting in April):
during the middle February to the middle March: Detailed survey to identify:

- data collection method and data availability
- data analysis method
- information and data network and work flow among sections in BKPM
- promotion strategy development method
- promotion tools development method

**Attachment 2 Scope of Work of the Study on
Realization of “Integrated Service”**

Attachment 2 Scope of Work of the Study on Realization of “Integrated Service”

1. Name of the Study
Study on the realization of “Integrated service”
2. Background of the Study
Investment approval and license procedure have been improved in the past few years at each level. However, there remain rooms to be improved. The main source of further improvement lies in realization of “Integrated service”. The Integrated service is for all parties concerned who are involved in investment procedure, to work together toward the investment promotion and under the same philosophy and principle that their mission is to serve investors.
3. Objective of the Study
The objective of the Study is to formulate the detailed plan for realization of “Integrated service” for investment approval procedure in Indonesia
4. Study area
The Study will cover the entire area of Indonesia. However, in developing “one roof service” models in local governments, several areas will be selected.
5. Scope of the Study
In order to achieve the above objective, the Study shall be conducted through the following activities
 - 6.1 Central government level
 - 6.1.1 Further improvement in issue of investment approval letter (SP)
 - Change the investment approval procedure in line with the change in negative list
 - Lessen hidden regulations
 - Set up a Pre-processing section
 - Prepare investor friendly manual
 - Simplify application form
 - 6.1.2 Further improvement in issue of Ministry of Justice’s letter on company registration (SK)
 - Coordinate the following matters with Ministry of Justice and Notaries public
 - Periodical issue of commentary on changes of related regulation on the procedures
 - Set up a round table meeting among Ministry of Justice, Notaries public and

BKPM

- Investigate the possibility of replacing domicile certificate with reference to Notary public

6.1.3 Further improvement in issue of customs approval letter (Master list)

- Revise arrangement of technical meeting
- Revise internal check process
- Periodical issue of commentary on application, when changes take place

6.1.4 Further improvement in issue of permanent business license (IUT)

- Revise internal check process
- Reconsider the necessity of IUT and revise its content
- Investigate the possibility of replacing with investment report

6.1.5 Further improvement in issue of commercial registration (TDP)

- Simplification of the process
- Introduction of E-process

6.2 One roof service at local governments

6.2.1 Research subjects

(1) Current situation of one roof service

- Identify local governments where the service is already available
- Questionnaire regarding “ One roof service ” to all related Kabupaten and Kota

(2) Current situation of the operation in the above local governments

- Characteristics of the region
- Legal basis
- Type of local permits and their procedures and time
- No. of cases for each permit
- Organization chart
- Function and activity
- Operation flow
- Manning and their qualification
- Utilization of IT
- Incentives
- Master plan-Spatial plan- Detailed plan
- Annual budget
- Problems and solutions
- Rating
- Source of success

(3) Current situation of the operation in the several (around ten) local governments where one roof service is not yet available

- Characteristics of the region
- Legal basis

- Type of local permits and their procedures and time
- No. of cases for each permit
- Operation flow
- Manning and their qualification
- Utilization of IT
- Incentives
- Master plan-Spatial plan- Detailed plan
- Annual budget
- Factors for which one roof service is not yet realized
- (4) Identification of best practice for realization of one roof service
 - Which case is the most desirable and easy to be transferred
 - Possibility that the best practice differs by region: in this case, identify the best practice considering each region's characteristics
- (5) Work design to transfer the best practice to each local government
 - Legal basis
 - Type of operation included
 - Organization chart
 - Operation flow
 - Introduction of IT
 - Staffing
 - Management
 - Budget
- (6) Develop mechanism assuring implementation
 - Incentives
 - Rating system
 - Competition with private sector
- (7) Discuss the possibility of introduction of the service with each local government
 - Presentation of the design
 - Revise the design to feasible one
- (8) Finalize the plan
 - Confirm through the discussion with parties concerned
 - Prepare tentative operational manuals
- (9) Seminar for dissemination

6.2.2 Expected major outputs

- Model of "One roof service" by region which reflects specific local condition and its rationale
 - a. One roof with multiple windows
 - b. One roof with single window
 - c. One roof and one stop window (authorization is delegated)
- Manual for realization of "One roof service"

- Know how to realize the service
- BKPM's supports towards realization of "One roof service"
- Mechanisms for successful implementation

6.3 Special consideration

In conducting the study for integrated service at local governments, consultants will pay a special attention to current situation of public servants' motivation toward better public service at local governments. Key is how to enhance their motivation. Best practice at local governments where integrated service has been already available is studied in details. In this connection, Japan's cases will be also studied when it is felt meaningful to do so. In Japan, in order to provide better and efficient public service, local governments have begun to introduce several new ideas and innovations as one of public service managements.

7. Work schedule

The Study will be conducted in accordance with detailed study flow shown in Annex 1 and tentative work schedule in Annex 2.

8. Assignment of consultants

For the Study, three consultants are assigned on full-time base

Annex 1 Detailed Study Flow

1. Preparation for the study
 - Present the purpose and scope of the study to BKPM
 - Get cooperation from sections concerned at BKPM
 - Simple questionnaire to all related Kabupaten and Kota
2. Analysis of factors affecting the relatively small percentage of investment realization (No. of IUT / No. of SP)
3. Select several examples of SP for whose local permits procedures are analyzed (BKPM)
 - For each advanced area with one roof service, three cases by industrial sector are selected (manufacturing, service and agriculture)
 - For each area without one roof service, the similar cases are selected
4. Operation flow for the above each case is investigated (Local governments)
 - Legal basis for the operation
 - How many staff are engaged for each process
 - Operation planning: first come first served?
 - How long does it take to complete each process: in and out
 - How the operation is proceeded: desk work and spot survey
 - Where each operation is done
 - Who and how monitors the operation
 - How much the office charges as service fee?
 - Where the operation is done
 - Documents to be produced
 - Incentives, if any
5. Compare the above cases and identify “Best practice”
 - Prepare comparison table
 - Set criteria for selecting “Best practice”
 - Evaluate each practice
 - Identify “Best practice”
6. Listen to investors’ (or consultants’) evaluation on the service
 - Areas with one roof service case
 - Areas without one roof service
7. Rough design for application of the Best practice to each area without one roof service
 - Legal basis
 - Operation flow
 - Standard time
 - Staff assigned
 - Information technology applied
 - Office layout
 - Management

8. Case studies for public service management in Japan
9. Design for mechanism of implementation
 - Incentives
 - Rating
 - Competition with private sectors
10. Presentation to and discussion with each area without one roof service
11. Design tailor-made one roof service to each area
12. Seminar for dissemination of one roof service

Annex 2 Tentative Work Schedule

Month	1	2	3	4	5	6	7	8	9	10	11
1. Central gov.(SP,SK,ML,IUT)		■			■						
2. Local gov.(One roof service)											
2.1 Preparation	■										
2.1.1 Statistical analysis on SP and IUT											
2.1.2 Selection of site for analysis											
2.1.3 Data and information gathering											
2.2 Analysis of examples of "One roof service"		■									
Batam SEZ, Kudus, Sulagen, Sidoarjo, Parepare, Bandung											
Summary;Difference in type and mechanism by local condition											
2.3 Identification of "Key to success in mechanism"		■									
2.3.1 Key by local condition											
2.3.2 Key for successful mechanism											
2.3.3 Best practice											
2.4 Interim report			□								
2.5 Analysis of areas without "One roof service"(10 areas)				■							
2.5.1 Preparation											
2.5.2 Execution											
2.6 Identification of issues to be solved for introducing "One roof service"					■						
2.7 Case studies in Japan						□					
2.8 Investigation of possibility of applying the Best practice							■				
2.9 Establish two-three models for "One roof service"								■			
2.8.1 Factors affecting models											
2.8.1 Classification of above 10 areas											
2.8.3 Draw models											
2.8.4 Contents of models											
2.8.5 Mechanism in each model											
2.10 Discussion on the possibility of applying models to each area								■			
2.9.1 Presentation and discussion											
2.9.2 Additional works for amendment											
2.11 Draft final report									□		
2.12 Preparation of action plans for realization											
2.13 Seminar for dissemination of the study result										■	
2.14 Final report										■	*